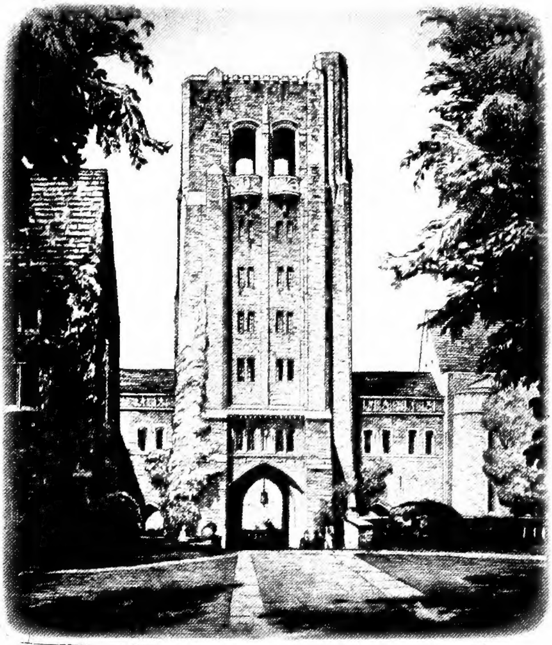

GUARANTY INSURANCE.

A TREATISE

ON

GUARANTY INSURANCE

AND

COMPENSATED SURETYSHIP

INCLUDING THEREIN AS SUBSIDIARY BRANCHES

THE LAW OF FIDELITY, COMMERCIAL
AND JUDICIAL INSURANCES

COVERING

ALL FORMS OF COMPENSATED SURETYSHIP, SUCH AS
OFFICIAL AND PRIVATE FIDELITY BONDS,
BUILDING BONDS, PROBATE BONDS,
COURT BONDS, CREDIT AND
TITLE INSURANCES

BY

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ORGANIZATION OF CORPORATIONS," "THE FRENCH
CONSTITUTION OF 1793," ETC.

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TO THE MEMORY

OF

My Father

THOMAS G. FROST

Late of the Chicago Bar

THIS TREATISE IS DEDICATED AS A TRIBUTE TO ONE WHO LIVED A LIFE TRUE TO THE BEST AND HIGHEST IDEALS OF THE PROFESSION

PREFACE TO THE SECOND EDITION

THE subject-matter of "Guaranty Insurance and Compensated Suretyship" has been so amplified and augmented by numerous decisions of the courts, handed down and reported during the six years that have intervened since the first edition of this work appeared, that a new and thorough revision thereof has become a matter of necessity.

At the suggestion of members both of the bench and bar, the author has inserted in this revised edition of his work more of his own views on the various questions under discussion than he thought wise or desirable in writing the earlier edition. In revising the work, more than two hundred and fifty pages have been added. Recent decisions numbering over five hundred have been digested and commented upon as their importance seemed to demand. In this revision will be found not only a comprehensive treatise on Fidelity Insurance, but also an enlarged and extended discussion of those not less important branches of Compensated Suretyship known in common parlance respectively as Contractors', Official, Administration, and Statutory Bonds.

The aim has been to embrace in one volume separate and distinct treatises on the three subjects of Fidelity Insurance (including public and private bonds), Commercial Insurance or Contract Bonds, and Judicial Insurance or Court and Administration Bonds.

THOMAS GOLD FROST.

76 WILLIAM ST., NEW YORK CITY,
September 1, 1908.

PREFACE TO THE FIRST EDITION

Every lawyer owes a debt, be it great or small, to his profession. If he can repay that debt by contributing something to the learning of his calling, he is but satisfying a highly meritorious obligation. The life of the twentieth-century advocate is a busy one, full of ceaseless activity and arduous labor in the service of that most jealous and exacting of all professions, the law. It is difficult to snatch the necessary leisure from the demands of active practice to do the careful and laborious work required of one in the proper preparation of a text-book on any important legal subject. In the case of the author of the present work, this has been by no means easy of accomplishment. The preparation of a work upon guaranty insurance was commenced by the writer several years ago, in response to what was even then an urgent demand for a work on a subject of growing importance. One thing or another has delayed its completion until the present time. In some respects this delay has been fortunate, for it has permitted the use of a large body of exceedingly valuable case law, which has appeared during the intervening period.

No one, properly conscious of the difficulties of writing a "pioneer treatise" on any important branch of the law, can approach such a broad and comprehensive subject as that of guaranty insurance without feeling a keen sense of responsibility, as well as a disinclination to be the first "to break the soil." But the experiences of active practice, wherein for many years the writer has been associated on one side or the

other of many cases involving contracts of guaranty insurance, has afforded that necessary practical acquaintance with his "tools" which every legal writer should possess. The present work endeavors to present both the theory and practice of all the various branches of guaranty insurance law. An honest — and it is hoped successful — effort has been made to avoid being dogmatic in statement, which will serve to explain why such copious extracts from the reports have been embodied herein. On such a new and inviting field as the present there is every inducement, in the frequent absence of either well-settled principles or precedent, for an author to state dogmatically what the law should be. No one, conscious of the newness of such a subject as guaranty insurance, would care to risk his professional reputation in such a manner. The theory, if such it may be called, upon which this work is written has been that of leaving to the courts their natural and allotted task of defining the unsettled principles of guaranty insurance law by future adjudications; while to the writer of a legal treatise belongs the less pretentious task of digesting the "case law" of to-day, with a view of deducing therefrom such rules and principles as a close and intelligent reading may seem to justify.

With a consciousness that the preparation of the work here submitted to the profession has enlisted his best efforts, and in the hope that it may meet with a generous and charitable reception at their hands, the writer desires "to submit his case without further oral argument on the written brief."

THOMAS GOLD FROST.

NEW YORK CITY,
September 23, 1901.

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THE LAW OF GUARANTY INSURANCE AND COMPENSATED SURETYSHIP.

INTRODUCTION.

ORIGIN AND HISTORY OF GUARANTY INSURANCE.

THE domain of insurance law has, by a process of gradual accession, become imperial in scope and extent. The limitations of this branch of our jurisprudence are no longer to be found in fire, marine, and life insurance contracts. To them have been added in turn other correlated subjects of insurance law. Among these may be named accident, employer's liability, plate glass, burglary, bicycle, and guaranty insurances. It is the last-named branch only, that of guaranty insurance, which will be discussed in the present work.

This branch of insurance law, though comparatively of recent origin, is already one of great and increasing importance. To the necessities of commerce and the more exacting demands of modern business methods it owes its very existence. It may not be without its practical value in the work at hand to trace briefly the historical development of that oldest form of guaranty insurance known in the business world as "fidelity insurance." The first public notice, as far as can be learned, of the proposed formation of a guaranty insurance company for the purpose of insuring the fidelity of employees appeared in 1720, in the "London Daily Post," and read as follows:

"Whereas, notwithstanding the many excellent laws now in force for punishing hired servants for robbing their masters or mistresses, yet noblemen as well as commoners are daily sufferers; and seldom a session but great numbers are convicted, to the utter ruin of many families, as also a scandal to

the Christian religion. This is to give notice that at the request of several housekeepers, books will be opened next Saturday at the Devil Tavern, Charing Cross, at ten o'clock, wherein any person may subscribe, paying 6 pence p. c. for a share called a £1000 stock; no more shares than 3000 and the call for stock not to exceed 10s. p. c. the first year by quarterly payments. This society will insure to all masters and mistresses whatever loss they shall sustain by theft from any servant that is ticketed and registered in this society."

But it was not until the appearance, in 1840, of Professor DeMorgan's article in the "Dublin Review," discussing the feasibility of fidelity insurance and its relation to the laws of general average, that the matter took definite shape. Professor DeMorgan's article was based on the crude proposition that the number of persons out of a thousand taken at hazard who cannot resist a given temptation will be found to be nearly the same as those in another thousand who cannot resist it. From this germ the present form of compensated suretyship known as fidelity insurance is a natural outgrowth. The underlying principles, nature, and theory of this important branch of guaranty insurance have not even at this day become clearly defined and crystallized. This much, however, may be said: The doctrine of general average, so universal in scope in general insurance law, has in fidelity insurance a greatly restricted application. The reason for this lies in the consideration at all times paid both to local conditions and to the personality of the "risk." Thus, for example, the effectiveness of a criminal code and of criminal procedure have a direct bearing upon the doctrine of general average in a given community. Also, by reason of heredity and family connections, the chance of loss might be greatly lessened by issuing insurance bonds only to persons whose family history was untainted by crime, and whose family ties would in themselves prove a strong barrier against the commission of crime. In short, the doctrine of general average in fidelity insurance means in these days, not an average among the community at large, but an average obtained with reference solely to those

persons possessing such necessary moral, family, and financial requisites as to entitle them to be designated as "proper risks."

To continue, now, with the history of fidelity insurance — it was not until 1840 that a company was organized for the transaction of this class of insurance business. The latter was organized in England, and was known as the "Guaranty Society of London." Mr. Francis, in his "Annals of Life Associations" (1853), says in reference thereto: "When this company was first started, in 1840, for insurance against loss by dishonesty of clerks, there was a great objection raised. It was thought to be one of those vague and speculative undertakings of which England has seen so many, and one which would necessarily fail, because the master would necessarily hesitate to take an assistant who could only give the security of a commercial company. 'The moral security is wanting,' was the exclamation of all. It was vain to answer that the objection pointed both ways, or that a relative would often give the required bond which a mercantile company would refuse. Still the parrot reply was heard, and the solemn shake of the head was followed by 'the moral security — where is the moral security?' And this was deemed sufficient to crush all argument derived from mere statistics. Time passed, and it was discovered that because the banker's clerk gave the security of a company, he did not become a rogue, but he did become independent. It was found, too, that the master would make his claim good on a company with far more promptitude than he would on a relative. It was nothing to say to a board of directors, 'I will have justice and my bond,' but it was something to say to a broken-hearted parent, 'Your son has ruined you as well as himself; discharge your obligations.' It is well known that bankers and merchants have often foregone their due, rather than thus reimburse their losses; and it has been found that, notwithstanding the fact of the moral security being wanting, the societies which guarantee the master from loss by the servant have been very successful, and are on the increase."

As early as 1842 the creation of guaranty insurance companies was recognized by successive Parliaments in England, and on June 18, 1842, were passed the Guaranty Society Acts (5 Victoria, Chapter 64). These were followed on April 19, 1859, by the European Society Acts (22 Victoria, Chapter 25), and on August 20, 1867, by the Guaranty Company Act (30 & 31 Victoria, Chapter 108); on July 25, 1872, by the European Assurance Society Arbitration Act (2 & 26 Victoria, Chapter 145), and on August 11, 1875, by the Government Officers' Security Company Act (38 & 39 Victoria, Chapter 64). At the present time there are said to be in the neighborhood of forty guaranty insurance companies organized and doing business in England and on the continent of Europe. When we turn to the United States, we find that guaranty insurance had a much later development. In the "Insurance Times," published in New York City (December Number, 1873), it was said that "guaranty insurance is unsuited to the needs and necessities of this country." However, under an act of the New York legislature passed March 31, 1880, the Knickerbocker Casualty Company was established, the name being afterwards changed to that of the Fidelity and Casualty Company of New York, and before the close of the year this latter company began to issue bonds guaranteeing the fidelity of persons holding positions of trust. It is reasonably safe to say that the principle controlling such risk assumption was the development of the marine hazard styled "barratry of the master of marines." The conducting of this class of business in the United States had been frequently suggested and recommended by insurance writers and journalists as early as the year 1877. Guaranty insurance has been in vogue in Canada since 1868. To turn now from the history to the philosophy of the subject, it has been well said that "guaranty insurance grapples with the operation of the human will, and, while admitting the temptations which constitute the necessity for protection sought, credits mankind with resisting causes which exist against wrongdoing, and so arrive at a medium capable of precise

estimate. It has not created an evil, only emphasized its existence and improved the method of dealing with it. It is exclusively a technical moral hazard; that is, a hazard whose basis is essentially the integrity of the person whose conduct forms the basis of the risk. Guaranty insurance rests upon the admitted necessity in the modern business world of greater protection to individual ownership and personal rights. It speaks for liberty, as well as for the reciprocal duties of each to all, and all to each. It tends towards equalization, with the normal differentiations of society, in so far as it equalizes loss, misfortune, and deprivation. One curious thing to be noted in this connection is that rates for guaranty insurance do not vary in the same class of employees in proportion to the separate risks involved in each individual instance. This would seem to be on its face somewhat at variance with well-recognized rules in other branches of the insurance business. But the remedy in the case of the guaranty insurance business (with reference to the prevention of the incurrence of risk, not commensurate with the premium to be paid) is found, not in an increase of premium, but in the rejection of risks."

The carrying of fidelity insurance risks has, indeed, had a most wonderful development both in this country and abroad. Within the United States there are now nearly a score of companies, with a large capitalization, engaged in the guaranty insurance business. Considered purely from a business standpoint, this growth is easily explainable. Whether looked at in the light of compensated suretyship or as a differentiated form of insurance, or both, it has its marked advantages. In its first character, as just outlined, it offers oftentimes the only method of obtaining positions of responsibility and trust. It relieves friends and relatives of the onerous and sometimes dangerous burden of becoming private sureties, and at the same time encourages good character, as that is the customary basis of guaranty insurance. To the one who receives the benefit of such insurance it offers a security certain, sure, and easily obtainable, freed from the uncertainties which

unavoidably attach to private suretyship. Again, in its twofold character, that of a multifold restricted form of casualty insurance as well as a contract of suretyship for hire, it likewise has its merits. It takes away by one stroke the ever-present contingencies of pecuniary loss arising from causes which the utmost business foresight and caution cannot guard against. Such losses as are here referred to, coming to men of small or even moderate pecuniary means, might involve insolvency and financial ruin. But the question may be asked, "Why not make use of the old time private bonds once so generally in use?" Such bonds are objectionable, for a number of reasons. First, because the financial status of the bondsmen must be scrutinized in advance; second, because, in case of loss, recovery is not unlikely to be defeated on technical grounds not open to modern fidelity bonds, or by reason of the inability of the bondsman to meet the obligation. It was in order to meet this objection that guaranty insurance companies were formed. These met with a favorable reception at the hands of the business world, for several reasons. Among these may be mentioned the fact that in most instances the financial status of these companies needed but little investigation and admitted of no question, as their board of directors were ordinarily in themselves a guarantee of good faith. But best of all was the business necessity, felt by all insurance companies, of paying losses promptly. There appeared, too, as time wore on, other advantages than those affecting merely the convenience, comfort, and security of the assured. These insurance companies, both in England and in the United States, inspect their risks most scrutinizingly. Under the rules now in vogue no policy is issued except upon far-reaching inquiry into the character, habits, and qualifications of the person bonded. He must tell his past employment, his business history, his family associations, and his pecuniary condition. His former employer and his references are called upon for information, and where all these fail to make a satisfactory record, other inquiries are undertaken. Under this system, too, policies are frequently refused because the busi-

ness system of the employer is defective, whether as respects methods of bookkeeping or of the collection, disbursement, and custody of moneys. Such scrutiny cannot fail to have a restraining influence upon the person bonded, and for his good.

From what has been here said, it will clearly appear that the business of guaranty insurance both here and in England can and has been made to conform to customary and time-honored insurance methods. A company doing such business must not expose itself on any risk to an unduly large hazard. It must limit the time for which its policies run; it must keep careful classification of the risks and of its losses within classifications; it must thoroughly inspect its risks in advance and at frequent intervals.

In theory, as has already been observed, it is like other branches of insurance law, — based upon the law of general average. From the nature of the risks covered it depends very largely for its financial success upon the existence of a high standard of morality in the communities where it seeks to do business. It is this element, far more than the deterrent effect of the probable punishment for crime committed, which lies at the very basis of guaranty insurance. The safety of such a business consists in inducing those who are covered by its policies to believe "that honesty is the best policy," and to act accordingly. It recognizes the market value of a good reputation, right living, creditable family connections, and a good home. It endeavors to make the securing of a bond by a private individual a mark of honor. It seeks to promote, to some degree at least, an *esprit du corps* among those who reap its unquestioned advantages.

It is probably true that it is the settled policy of the business world at the present time for men to surround themselves and their business with absolute protection, and to this end they insure their lives and property. In this last connection it is now frequently the case that losses from dishonest employees are insured against by both corporations and individuals engaged in large business enterprises.

While this is true of business men generally, it has been a custom of banks, railroad, express and telegraph companies for years to insist on the procurement of fidelity bonds by their employees. Their reasons for doing this are many. It is claimed that in this way a superior class of employees is obtained. This for the reason that "surety companies" require the best of testimonials and the strongest evidence of integrity in applicants before issuing their bonds. Investigation of the antecedents and character of the applicants is usually much more thorough than it would be possible for the employer to make himself, and the granting of bonds is not only a safeguard for the employer, but is often the best recommendation the employees can secure.

It is undoubtedly true that placing an employee under bond throws around him a wholesome restraining influence, for when thus under bond he knows that another obligation than that of faithfulness to his employer rests upon him.

Still again, looked at from the standpoint of actual business experience, it is a well-known fact that the most prudent and conservative financial institutions, exercising the strictest supervision, now generally require their employees occupying positions of trust to be bonded against any fraudulent conduct involving a loss to the institution. No supervision, however careful or thorough, ever prevents losses of this character. No system of keeping accounts or examination ever eliminates this risk. The most that can be expected is to discover the fraud before the loss becomes serious. Hence it is that only bonds for sufficient amounts to cover this character of risks are required and accepted. The amount of the bond is but a small percentage of what the employee may have access to in the usual course of his employment, but with a proper system of examination the chance of any defaults becoming serious before discovery is minimized. Experience teaches that honest men rarely become dishonest in a day. Temptation, when first encountered, is easily resisted; with each succeeding encounter the power of resistance is weak-

ened. Defaults are small in the beginning, and gradually increase to enormous amounts, if not soon detected. Persons of experience and observation have found that those in positions of trust who speculate in stocks, grain, provisions and like commodities, invariably lured on by the hope of retrieving past losses, become defaulters to large amounts. It has been observed that persons in positions of trust who are in the habit of gaming will sooner or later become losers, and in consequence defaulters, though the defaults consequent on such misconduct are not nearly so large as those resulting from speculation involving sums far greater than those at risk on games of hazard. Then, too, where an employee has once yielded to temptation and defaulted, he is likely to repeat the act. It is generally true that persons in positions of trust who live beyond their income are likewise greatly exposed to the temptations of small peculation, particularly if addicted to immoralities and other excesses. So, also, experience teaches that the risk is very much increased by the employee who is handling money being harassed by debt. Even a man's daily habits and associations determine very largely the likelihood as to whether he will continue in the faithful discharge of his duties. It has been found that, outside of and beyond these personal elements, the character of the supervision over the employee for the prevention of default, and the probability or improbability of an early discovery of shortage, are factors of the highest importance in determining whether or not it is likely that an employee will be guilty of his first embezzlement. The largest defalcations are usually followed by statements from the unfaithful employee's superior officer that he was a too much trusted employee, who had for years been abstracting the funds intrusted to him. Financial institutions do not procure bonds of suretyship to take the place of the duties incumbent upon the managers of such concerns, but to protect a risk ever present with the strictest supervision and the most approved system of keeping accounts. The interests of the insured and the insurer are identical. Each is interested in and seeks to prevent a default; each desires super-

vision of such a character as to forbid opportunity for default, and to render discovery certain before such default becomes serious.

The foregoing is a brief, but perhaps not wholly useless, presentation of the genesis and philosophy of that great branch of guaranty insurance known as fidelity insurance. The two remaining branches of the subject, denominated herein as "commercial" and "judicial" insurances, are relatively less important, and are more recent developments of the business of guaranty insurance, otherwise known as compensated suretyship. These last owe their existence to the greater and more exacting demands of modern business methods, and are daily becoming of increasing importance in the commercial and judicial worlds.

PART I. — THE CONTRACT

CHAPTER I

GENERAL CONSIDERATION OF THE CONTRACT OF GUARANTY INSURANCE

§ 1. **Guaranty Insurance defined.** — The term "guaranty insurance" is generic in its scope and signification, and embraces within it those subsidiary species of insurance contracts known as "fidelity," "commercial" and "judicial" insurances. The foregoing classification has been quite generally adopted by the courts and text-book writers, as well as by the surety companies themselves, and may now be regarded as well established.[1]

In legal acceptation guaranty insurance is an agreement whereby one party (called the "insurer") for a valuable consideration (termed the "premium") agrees to indemnify another (called the "insured") in a stipulated amount against loss or damage arising through dishonesty, fraud, unfaithful performance of duty or breach of contract on the part of a third person (hereinafter denominated as the "risk") sustaining a contractual relationship to the party thus indemnified.[2]

The development of the rules and principles of guaranty insurance is of such comparatively recent origin that in Eick-

[1] See Cowles *v.* U. S. Fid. & Guar. Co., 32 Wash. 120; 72 Pac. 1032; Cyclopedia of Law & Proc., vol. 20, p. 1498; Cooley's Briefs on Ins., vol. 1, p. 9; Childs on Suretyship & Guar., p. 12; Eickhoff *v.* Fid. & Cas. Co., 74 Minn. 139; 76 N. W. 1030.

[2] See Cowles *v.* U. S. Fid. & Guar. Co., 32 Wash. 120; 72 Pac. 1032; Cyclopedia of Law & Proc., vol. 20, p. 1498; Cooley's Briefs on Ins., vol. 1, p. 9; Childs on Suretyship & Guar., p. 12; Eickhoff *v.* Fid. & Cas. Co., 74 Minn. 139; 76 N. W. 1030; U. S. Fid. & Guar. Co. *v.* First Nat. Bank, Ill. ; 84 N. E. 670.

hoff *v*. Fidelity and Casualty Company of New York[1] reference is made by the Supreme Court of Minnesota to the fact that in 1893 the law in regard to guaranty insurance was then unsettled. In the words of the Illinois Supreme Court: "Guaranty Insurance is so much more modern in origin and development than fire, marine, life and accident insurance that there are few decisions upon the subject, but the business is gradually increasing and is doubtless destined to take an important place in the commercial world."[3]

The remarks of the Pennsylvania Supreme Court on this subject are most interesting. Commenting on the general subject of guaranty insurance, that court spoke as follows:[4]

"Viewed in this light the act of 1895 is not at all within the prohibition. The objection is essentially based on the assumption that the suretyship of a corporation and of an individual are identical, and that the act therefore makes a discrimination between equally qualified sureties for the same service. But this assumption is not sustained by the facts and overlooks the material distinction between the qualities of the security afforded. These distinctions are obvious. The individual surety formerly was usually a relative or friend who had the confidence of the principal, and voluntarily assumed the obligation of answering for the latter's faithful performance of duty. We do not speak of the individual becoming a surety for pay, for the very name, the 'professional bail-goer,' is a reproach to every branch of the administration of justice which he was allowed to contaminate with his presence. But the voluntary surety, however honest and well qualified at the time of his approval by the court, is liable to the contingencies of business, the changes of value in property and the inexorable chance of death, which brings his estate into the administration of the law under wholly changed circumstances. Of the happening of any of these contingencies the only person in position to keep a close watch is the principal, and his interest is adverse to making known any doubt as to the sufficiency of his friend or to assume the burden of finding a new surety. These are some of the

[1] 74 Minn. 139; 76 N. W. 1030.

[2] U.S. Fid. & Guar. Co. *v*. First Nat. Bank, Ill. ; 84 N. E. 670.

[3] See also Granite Bldg. Co. *v*. Sayville Adminis., *et al*., 101 Va. 217; 43 S. E. 351; Cole *v*. Am. Sur. Co., Miss., 44 So. 771; Fid. & Dep. Co. *v*. Butler, Ga.; 60 S. E. 951; Willoughby *v*. Fid. & Dep. Co., 16 Okla. 546; 85 Pac. 713.

[4] Clark's Estate, 195 Pa. St. 520; 46 At. Rep. 127.

disadvantages even of an honest surety, and if we add to them the risk of a dishonest one who may dispose of his property on his own scent of danger or on a friendly hint from his principal, we may have a fair idea of the dangers of which our reports present many illustrations. On the other hand, the surety company included in the provisions of the act of 1895 must have a capital, the amount, nature of investment, and management of which are known and within the constant sight of the court and persons interested; it is obliged to make report of its condition to the courts and to the commonwealth and is at all times subject to the visitorial power of the latter; and finally, it has the sharp incentive of prevention of loss by looking closely after the administration of his trust by its principal for whom it has become responsible not from friendly personal confidence but as a strict business venture. It was said in this case by the learned president of the orphan's court whose utterance entitles his opinion to great weight, that, 'corporation suretyship, another product of modern thought and ingenuity, may be said to possess many advantages over individual security.' Our daily experience has proved that corporate security and the oversight and management by expert officers of the trust and security companies are highly advantageous not only to the fiduciary but to all the parties interested, whether creditors, legatees or distributees. But even if this be not so, it is plain that while the duties and liabilities of the surety, whether corporation or individual, are the same, and in those respects they stand upon the same plane, yet the qualities and advantages of the security afforded are materially different. It is on this difference that the discrimination under the act of 1895 is founded, and it is a fair and constitutional basis for the legislative discretion."

§ 2. **Scope of Guaranty Insurance.** — For purposes of classification and treatment herein, guaranty insurance contracts may be divided into three general classes, — those of fidelity, commercial, and judicial insurances.

Of these, fidelity insurance has reference to insurance bonds or policies issued upon persons occupying fiduciary relationships with the insured, whose faithful performance of duty therein is guaranteed by such policies. The fiduciary relationships here referred to embrace those both of a public and private nature; such, for example, as those existing between officials and the public, between corporate officers or agents and the corporation; and generally between employers and

employees, to whom is intrusted the disbursing of funds or the handling of property.

Commercial insurance is a popular and very elastic term, having reference to indemnity agreements issued in the form of an insurance bond or policy, whereby parties to commercial contracts are, to a designated extent, guaranteed against loss by reason of a breach of contractual obligations on the part of the other contracting party. To this class belong policies of "contract," "credit," and "title" insurances.

By judicial insurance reference is had to insurance bonds or policies issued, in connection with the regular course of judicial or administrative procedure, for the purpose of securing the faithful performance of duty on the part of court appointees, to guarantee due compliance with the terms of undertakings entered into by parties litigant before the courts, and to secure proper administration of statute law.

§ 3. **The Nature of Guaranty Insurance.** — Looked at from a purely legal standpoint, to what class of contracts does the instrument issued by the so-called surety companies in the form of an insurance bond or policy belong? Is it in fact, as well as in form, a contract of insurance? Further, even assuming it to be a contract of insurance —Why should it be called "guaranty insurance"? To answer the foregoing questions in any satisfactory manner requires a brief examination not only of insurance principles generally, but likewise of those governing contracts of suretyship, guaranty and indemnity. A great deal of unnecessary time and energy has been spent in attempting to distinguish along hard and fast lines the contract of a surety from that of a guarantor. Much of the confusion, it would seem, that has arisen on the subject might be avoided by considering suretyship as a generic word, embracing all cases in which one person is primarily liable and another person is secondarily liable, and where the latter has a remedy over and against the former. It does not necessarily flow from the contract itself, but may arise from equitable principles. The relation of principal and surety may be

said to exist when the obligation is secondary and successive, as distinguished from a liability which is joint and equal. This relation may be created by operation of law as well as by contract, and may be established by parol proof as well as by the express words of the instrument. Although the terms of the instrument bind the surety equally with the principal, the surety is allowed to show, in contradiction of the obligation as expressed therein, his true relation by extrinsic evidence. A guaranty, on the other hand, comes properly within the definition of suretyship given above and is in itself a much narrower expression, being applicable solely to express or special promises to answer for the debt, default or miscarriage of another.[1]

It has been observed not infrequently by the courts that in contracts of guaranty insurance the more natural attitude of a surety is assumed by the form thereof.[2]

But in a recent case involving the construction of a fidelity insurance bond, it was said that in their very form and essence such bonds resemble insurance contracts, and differ materially from the ordinary forms coming down to us by immemorial usage.[3]

In the case just referred to the term " common surety " was applied to the surety company, and in explanation of this use of the term the court observed that the latter " had voluntarily become by virtue of statute what may be called a ' common surety,' not exactly in the nature of a common carrier, like railroad and telegraph companies, but still one of these

[1] See Dwight's Notes on Contracts, vol. 1, Columbia Law Times, 135; also A. B. Small Co. *v.* Caxton, Ga. ; 57 S. E. 977.

[2] Guar. Co. of N. A. *v.* Mech. Sav. Bank & Tr. Co., 80 Fed. 766; 26 C. C. A. 146; 47 U. S. App. 91, reversed in 183 U. S. 402; 46 L. E. 253.

[3] Bank of Tarboro *v.* Fid. & Dep. Co., 128 N. C. 366; 38 S. E. 908. See also Willoughby *v.* Fid. & Dep. Co. of Md., 16 Okla. 546; 85 Pac. 713; Remington *v.* Fid. & Dep. Co. of Md., 27 Wash. 429; 67 Pac. 989; Champion Ice & Cold Storage Co. *v.* Am. Bond. & Tr. Co., Ky. ; 75 S. W. 351; Granite Bldg. Co. *v.* Sayville Adminis., *et al.*, 101 Va. 217; 43 S. E. 351; Pacific Nat. Bank of Tacoma *v.* Ætna Indemn. Co., 33 Wash. 428; 74 Pac. 590.

common agencies to which are given unusual powers and which have assumed the most sacred responsibilities. Permitted by law to act as sureties for trustees, guardians, administrators or other fiduciaries, they are held by the policy of the law to the full measure of the responsibilities they voluntarily assumed. They may make such reasonable regulations as are necessary for their own protection or the proper transaction of their business; but all stipulations will be most strongly construed against a forfeiture of the indemnity for which alone the bond is given, and in favor of a fair and equitable construction of the essential purpose of the contract."

Again, treating a guaranty as a form of a suretyship, it should be noted that the words "guaranty" and "insurance" have to a great extent the same meaning and effect, and many contracts may, with equal propriety, be called contracts of insurance or contracts of guaranty. There is no hard and fast line to be drawn between contracts of insurance and contracts of guaranty. But speaking generally, the former have several features in their character and in the way they are effected which distinguish them from ordinary contracts of guaranty.[1]

Next, if what are strictly indemnity contracts be contrasted with contracts of suretyship or guaranty, it will be observed that the indemnitor in such indemnity agreements undertakes to protect his indemnitee against loss or damage arising through a liability on the part of the latter to a third party, while the undertaking of a surety or guarantor as promisors is to protect their promisee against loss or damage arising through the failure of a third person to carry out his obligation to such promisee.[2]

This leads naturally to the remark that while all guaranty insurance bonds or policies are, in one sense, contracts of in-

[1] See Seaton *v.* Heath, 1 L. R. App. Cas. for 1899, p. 782; Cole *v.* Haven, Ia. ; 7 N. W. 383.

[2] Ky. L. S. B. Ass'n. *v.* Miller, Ky. ; 84 S. W. 301; Carpenter *v.* P. W. Ins. Co., 16 Peters, U. S. 495. See Northern Assurance Co. of England *v.* Borgelt, *et al.*, 67 Neb. 282; 93 N. W. 226.

demnity, yet they are such only because of their inherent nature as insurance agreements, seeking to provide indemnity to those insured. Unlike strict indemnity contracts they are issued as matters of speculation and not from motives of friendship, and are usually accompanied by a formal written application for the same, and are themselves made subject to certain conditions and limitations unknown to the more simple indemnity contracts. Then, too, they are supported by a separate and distinct consideration running from the insured to the insurer.[1]

If the purpose be to find points of resemblance in the several classes of contracts heretofore referred to, it may be noticed that in each of them the right of subrogation, whether it be in favor of the surety, guarantor, indemnitor or insurer, is recognized and enforced.

The obligation respectively of the surety and the insurer is a primary one, so far as concerns the right to proceed against them in the first instance, to enforce their liability, is concerned, but collateral in the sense that such obligation is entered into with reference to the contemporaneous existence of a separate contract existing between the principal and the obligee in the one case or the "risk" and the insured in the other.[2]

As throwing light upon the foregoing, attention is called to a recent Nebraska case,[3] where, in commenting upon the nature of a fidelity bond issued by a surety company, the court observed as follows: "It is true a contract of this character is a form of insurance, but it is something more than a contract of insurance. The latter is usually based on the application of the insured who pays the premium, and is between himself and the insurer alone. The bond in suit was issued on the application of the employee, who paid the premium, and

[1] See Remington *v.* Fid. & Dep. Co. of Md., 27 Wash. 429; 67 Pac. 989. *In re* Denton's Estate, L. R. 2 W. H. Div. 178.

[2] See U. S. Glass Co. *v.* Mathews, 80 Fed. Rep. 828; 32 C. C. A. 364; U. S. Fid. & Dep. Co. *v.* Ridgley, 70 Neb. 622; 97 N. W. 836; Iowa L. G. Mining Co. *v.* Bliss, *et al.*, 144 Fed. 446.

[3] U. S. Fid. & Dep. Co. *v.* Ridgley, 70 Neb. 622; 97 N. W. 836.

contemplates not only a contract of indemnity between the plaintiff (the insured) and the defendant (the insurer), but also a contract between the defendant (the insurer) and the employee (the 'risk')."

In a certain restricted sense, sureties, guarantors and indemnitors are insurers. The surety is an insurer of his principal's obligations, and liable as such in the first instance. The guarantor is an insurer of his principal's financial ability to meet certain designated pecuniary obligations. The indemnitor is an insurer that the assuming of certain obligations by the indemnitee to a third party shall not result in pecuniary loss to such indemnitee.

In view of all that has been said in this immediate connection, can it be affirmed that fidelity, commercial and judicial bonds or policies, as issued by the so-called surety companies, constitute a contract of insurance within the strict legal signification of that term? *The answer to the foregoing query must be unqualifiedly in the affirmative.* That such policies are essentially insurance contracts has been settled by the overwhelming authority of a large number of courts of last resort, the decisions to the contrary being few and far between.[1]

[1] See People *ex rel. v.* Rose, 174 Ill. 310; 51 N. E. 246; Guar. Co. of N. A. *v.* Mech. Sav. Bank & Tr. Co., 80 Fed. 766; 26 C. C. A. 146; 47 U. S. App. 91; reversed in 183 U. S. 402; 46 L. E. 255; Am. Cr. Indemn. Co. *v.* Athens Woolen Mills, 92 Fed. 581; 34 C. C. A. 161; Bank of Tarboro *v.* Fid. & Dep. Co., 129 N. C. 366; 38 S. E. 908; Jackson *v.* F. & C. Co. of N. Y., 75 Fed. 359; 21 C. C. A. 394; Shakman *v.* U. S. Cr. Sys. Co., 92 Wis. 366; 66 N. W. 528; Tebbetts *v.* Merc. Cr. Guar. Co., 73 Fed. 95; 19 C. C. A. 281; People *ex rel. v.* F. & C. Co. of N. Y., 153 Ill. 25; 38 N. E. 752; Eickhoff *v.* F. & C. Co. of N.Y., 74 Minn. 139; 76 N. W. 1030; F. & C. Co. of N. Y. *v.* Crays, 76 Minn. 450; 79 N. W. 531; F. & C. Co. of N. Y. *v.* Eickhoff, 63 Minn. 170; 65 N. W. 351; State *v.* Hogan, 8 N. D. 301; 78 N. W. 1051; Robertson *v.* U. S. Cr. Sys. Co., 57 N. J. L. 12; 29 Atl. 421; Claflin *v.* U. S. Cr. Sys. Co., 165 Mass. 501; 43 N. E. 293; Hayne *v.* Met. Tr. Co., 67 Minn. 245; 69 N. W. 916; Strouse *v.* Am. Cr. Ins. Co., 91 Md. 244; 46 Atl. 328, 1016; Trenton Pottery Co. *v.* Tit. Guar. & Tr. Co., 64 N. Y. Sup. 116; 50 N. Y. App. Div. 490; Minn. Tit. Ins. & Tr. Co. *v.* Drexel, 70 Fed. 194; 17 C. C. A. 56; Gauler *v.* Tr. Co., 9 Pa. Co. Ct. R. 849; Wheeler *v.* Tr. Co., 160 Pa. St. 408; 28 Atl. Rep. 849; Fid. & Cas. Co. of N. Y. *v.* Yoder, 63 Kan. 880; 64 Pac.

In the words of the Illinois Supreme Court [1] surety bonds "must, we think, be regarded as an insurance contract, and as such subject to the rules of construction applicable to insurance policies generally, and not the rules applied to ordinary sureties for accommodation.[2] In this case this court further said that "Guaranty Insurance is in its practical sense a guaranty or insurance against loss in case a person named shall make a default or be guilty of specified conduct. It is usually against the misconduct or dishonesty of an employee or officer, though sometimes against the breach of a contract. This branch of insurance is so much more modern in origin and development than fire, marine, life and accident insurance that there are few decisions upon the subject, but the business is gradually increasing, and is doubtless destined to take an important place in the commercial world. It may be confidently stated, notwithstanding the comparative absence of specific decisions, that the general principles applicable to other classes of insurance are applicable here as well. Thus, the general doctrine of warranty, misrepresentation and concealment as applied to fire, life and marine insurance is applicable also to the subject of guaranty insurance. Contracts of guaranty insurance are made for the purpose of furnishing indemnity to the insured and they should be liberally

1027; Seaton *v.* Heath, 1 L. R. App. Cas. 1899, 782; Dane *v.* Mortg. Ins. Corp. 1 Q. B. App. Cas. 1897, p. 54; Finlay *v.* Mexican Ins. Corp., L. R. 1 Q. B. App. Cas. 1897, p. 517; U. S. Fid. & Dep. Co. *v.* Ridgley, 70 Neb. 622; 97 N. W. 836; Willoughby *v.* Fid. & Dep. Co. of Md., 16 Okla. 546; 85 Pac. 713; Remington *v.* Fid. & Dep. Co. of Md., 27 Wash. 429; 67 Pac. 989; Carstairs, *et al. v.* Am. Bond. & Tr. Co. of Baltimore, 116 Fed. 449; 54 C. C. A. 85; Champion Ice & Cold Storage Co. *v.* Am. Bond. & Tr. Co., 115 Ky. 863; 75 S. W. 197; Granite Bldg. Co. *v.* Sayville Adminis., *et al.*, 101 Va. 217; 43 S. E. 351; Pacific Nat. Bank of Tacoma *v.* Ætna Indemn. Co., 33 Wash. 428; 74 Pac. 590; Am. Bond. Co. *v.* Burke, *et al.*, 36 Col. 49; 85 Pac. 692; Geo. Wiedman Brewing Co. *v.* U. S. Fid. & Guar. Co., 49 Fla. 422.

[1] U. S. Fid. & Guar. Co. *v.* First Nat. Bank of Dundee, Ill. ; 84 N. E. 670.

[2] People *v.* Rose, 174 Ill. 310, 313; 51 N. E. 246; 44 L. R. A. 124.

construed to accomplish the purpose for which they were made."

§ 4. **The Principles of Guaranty Insurance contrasted with those of Private Suretyship.** — Notwithstanding the fact that the status of the "surety companies" has been judicially defined to be that of an insurer and not of a surety,[1] in the strict legal sense of the word, nevertheless there has been in times past, and there still is, an effort being made to induce the courts to engraft upon these new forms of contract practically the entire body of suretyship law and learning. In view of this fact, the question presents itself whether these policies which are issued by the "surety companies" are subject to the same rules and governed by the same principles as those bonds furnished by private sureties, once so common, but now rapidly disappearing under the encroachment of the system of compensated suretyship already referred to. This is a most practical question and one that must be met and answered at the very threshold of any proper treatise on guaranty insurance.[2]

It may be of interest to reproduce here the remarks on this subject made several years ago by the president of one of the leading guaranty insurance companies, as showing the practical view taken of this question from the insurer's standpoint. After calling attention to the fact that, so far as the courts were concerned, the law applicable to contracts of guaranty insurance was an unknown and untrodden field, he made these remarks, which now seem to be truly prophetic: "They" (the courts) "are going to apply the same rules to corporate suretyship that they do to other insurance companies. The individual surety is always met with sympathy, but" — they will say — "we are going to be pretty strict in our interpretation of the law as against you." Returning now to the contrasting of the principles of guaranty insurance with those of private suretyship, it may be said that the law reports are

[1] See *ante*, § 3.

[2] See Bank of Tarboro *v.* Fid. & Dep. Co., 129 N. C. 366; 38 S. E. 908.

full of decisions bearing upon the construction and interpretation of bonds of private suretyship, and the law on the subject is fairly well settled. For this reason it would be of great value in any discussion of the present subject to know in what respect, if at all, the principles of private suretyship are applicable to contracts of guaranty insurance. If they are fully applicable, or if in the main so, but otherwise not, it is no less important that the true extent of the application of such principles to contracts of guaranty insurance should be clearly recognized. Unless this is done at the very outset, much confusion will necessarily arise, and misleading applications of legal principles are likely to ensue. Wherein then, if at all, do the rules of law governing private suretyship apply to guaranty insurance contracts? The distinguishing features of guaranty insurance, as contrasted with gratuitous suretyship, are to be observed along two general lines. First: The existence in the former of a monetary consideration for the execution of the contract, known as a premium, proportioned to the amount and term of the liability to be insured; the other distinguishing feature being the extended application to guaranty insurance of the doctrines of representation, warranty and conditions precedent and subsequent as they exist at the present time in fire, life and marine insurance contracts.[1] It should be observed at the outset that the law is too well settled to admit of discussion, that ordinary sureties are favorites of the law and their obligations are in all cases to be construed in their favor under the well-known "*strictissimi juris*" rule.[2] Therefore, it may be stated as a general rule that ordinary sureties are not to be bound beyond the strictest terms of their engagements, and their liability is not to be extended beyond the clear and unequivocal terms of the obligation entered into by them.[3]

[1] U. S. Fid. & Guar. Co. *v.* First Nat. Bank of Dundee, Ill. ; 84 N. E. 670.

[2] Moreland School Dist. *v.* Picker, Pa., ; 14 Montgomery Co. 85; N. K. Fairbanks Co. *v.* Am. Bond. & Tr. Co., 97 Mo. App. 205; 70 S. W. 1096.

[3] Sather Bank. Co. *v.* Arthur Briggs Co., *et al.*, 138 Cal. 724; 72 Pac. 352.

The basis of the foregoing rule is not hard to find. It finds its support in the recognition by the courts of what is common knowledge in the business world, to wit, that a contract of suretyship as entered into by private persons is ordinarily a gratuitous one, induced by motives of friendship or by a promise of similar accommodation at some future date. Again, it is often assumed hastily without proper safeguards, in the form of contract stipulations, and almost always upon oral representation as to the scope and extent of the guarantee.

The obligation that is assumed is voluntary on the surety's part, entered into not only without profit, but likewise without having in view any prospect of gain. It is an act of benevolence on the part of the obligor, a convenience to the obligee, and of emphatic use to both. For these reasons the courts have said that the obligations of social duty require that the surety should be dealt with in fairness and in the utmost good faith.

The obligee and obligor are bound to know that, if they find it convenient to change or vary the terms of the original contract, they must seek the assent of the surety because it is his contract as well as theirs and if they will not do so, they take upon themselves the hazard and thus loose the bonds of the surety.

It is but natural that courts so long accustomed to extending the rule of favoritism towards the surety in the old-time private bonds, should be slow to recognize that with the passing away of the reason for the existence of the rule by the advent of the compensated surety, the rule itself should pass away.

The contract of guaranty insurance is invariably entered into for a compensation, and usually after the fullest investigation and frequently under stipulation largely technical in character, based upon written representations relative to the nature and extent of the risk. The policy is written by a company incorporated for the express purpose of furnishing guaranty bonds as a means of revenue to the corporation and

its stockholders. So much being admitted, the question then arises as to whether there are any valid reasons why two parties sustaining a distinct legal relationship with third persons, but bound to such third persons by contracts substantially the same in purpose, should be governed by the same rules of law? In response to this important question the following may be said by way of reply along the line of judicial answer to the foregoing query. Bound by the supposed presence of legal analogy between the two contracts and at the same time overlooking the now well-established fact that "compensated suretyship" is a branch of insurance law, and as such controlled by the principles thereof, some few courts have been led to apply the traditional favoritism rule to what are in reality policies of insurance, treating them as if they were in all respects identical in nature and effect with the old-time private bonds. This is quite generally the case in judicial insurance, far less so in commercial insurance, and scarcely at all in true fidelity insurance.

For the sake of exemplifying the attitude of those courts which persist in blinding themselves to the radical difference which exist between the respective contracts of the gratuitous and compensated sureties, attention is called to the case of N. K. Fairbanks Company *v.* American Bonding and Trust Company,[1] where the court observed as follows:

> "Much is said about the favoritism shown to sureties by the law and that their obligation is *strictissimi juris*, all of which is credited since the law began early to deal tenderly with sureties out of consideration for the gratuitous nature of their promises. It is the law that a surety has the right to stand on the strict terms of this agreement, but this agreement is to be determined by the same interpretation as applies to other contracts without technical nicety or distinctions."[2]

[1] 97 Mo. App. 205; 70 S. W. 1096.

[2] See also Fid. & Dep. Co. *v.* Beale, Va., 46 S. E. 307; U. S. Fid. & Guar. Co. *v.* Overstreet, Ky., 84 S. W. 764; H. S. & L. Ass. *v.* U. S. Fid. & Guar. Co., 197 Pa. St. 177; 46 Atl. Rep. 910; State to the use of Co. Com. *v.* John H. Hill & Fid. & Dep. Co., 88 Md. 111; 41 Atl. Rep. 61; Ind. School Dist. *v.* Hubbard, *et al.*, 110 Ia. 68; 81 N. W. 241; Am. Sur. Co. *v.* Thorn-Halliwell Cem. Co.,

We find the Maryland Court of Appeals in Union Central Life Insurance Company *v.* United States Fidelity and Guaranty Company [1] placing itself upon firmer ground in these words:

"Contracts of this character, like policies of fire insurance, to which they are closely analogous, though they are not strictly identical, must receive a reasonable construction so as to give effect to the intention of the parties thereto, so as to carry out rather than defeat the purposes for which they were executed. They should neither on the one hand be so narrowly or technically interpreted as to frustrate their obvious design, nor on the other hand so loosely or inartificially as to remove the obligor from liability fairly within the scope or support of their terms." [2]

Again this same court in March *v.* Fidelity and Deposit Company [3] observed " that when the statute enabled this corporation to become a surety, it described a relation perfectly well known and understood in law. Certain rights, duties, responsibilities and functions belong to the conditions of suretyship, and they are all necessary and conclusively implied when one lawfully becomes a surety. These incidents must attach to the suretyship in this case, unless the statute which authorized it establishes and defines a difference between it and the contract of ordinary suretyship."

This last remark furnishes the key-note to what is to follow. It is not to the statutes, but to the courts, that one must look to establish and define a difference, if such exists, between compensated and ordinary suretyship.[4] This the courts have, in the case of fidelity and commercial insurances, done, either by recognizing the different status occupied by the gratuitous

9 Kan. App. 8; 57 Pac. 237; U. S. to the use of Heise Bruns & Co. *v.* Am. Bond. & Tr. Co., 89 Fed. 925; 32 C. C. A. 420; U. S. to the use of Anniston Pipe & Foundry Co. *v.* Nat. Sur. Co., 92 Fed. 549; 34 C. C. A. 526; House *v.* Am. Sur. Co., 21 Tex. Civ. App. 590; 54 S. W. 303; Am. Sur. Co. *v.* Lauber, *et al.*, 22 Ind. App. 326; 53 N. E. 793.

[1] 99 Md. 423; 58 Atl. Rep. 437.

[2] See also Cr. Indemn. Co. *v.* Cassard, 83 Md. 267; 34 Atl. 703.

[3] 79 Md. 309; 29 Atl. Rep. 521.

[4] See Bank of Tarboro *v.* Fid. & Dep. Co., 128 N. C. 366; 38 S. E. 908.

as compared with the compensated surety, or else they have finally arrived at the safe and logical conclusion, that all such contracts are governed and controlled by the law of insurance and not by that of suretyship.

It may be well at this point to call attention to the fact that up to the present time the courts have adopted a different attitude in matters of construction in the case of fidelity and commercial insurance contracts, from that taken by them when construing judicial insurance bonds. It should be stated, however, that already there has been displayed in courts of highest authority a well-defined disposition to treat the contract of the compensated surety, as evidenced by the issuance of a judicial insurance bond, as materially different from that of the gratuitous surety. The writer confidently expects that ultimately the courts will allow no different construction to be placed upon judicial insurance bonds or policies from that applied at the present time to fidelity and commercial bonds.

In the case of commercial insurance it is now possible to state just what the policy of the law has been with reference to the construction of such bonds or policies. In the case of credit insurance policies issued by credit insurance companies, they have been construed strictly as contracts of insurance. The same is true with respect to title insurance.

When we come to contract insurance bonds, there has been of late a decided tendency — widely spread — to treat the "surety companies" issuing such policies the same as insurers rather than as ordinary gratuitous sureties. But in the domain of fidelity insurance, the trend of authority is all but unanimous in favor of the proposition that fidelity insurance is to be treated as a contract of insurance and not as a contract of suretyship, and that the insurer who issues such policies does not occupy the same position before the courts as does the private surety who signs a fidelity bond without compensation and outside of the line of his ordinary business. In support of this last statement attention is called to the case

of Walker *v.* Holtzclaw, *et al.*,[1] where a guaranty insurance policy was before the court for construction. The court there said:

"Upon hearing of the case it was argued that a surety is a favorite of the law, and it (the policy) should be strictly construed in his favor. While this is true, as a general rule, it has no application to a case like this, where the surety receives compensation and the surety is in the line of its regular business." Judge Lacombe, speaking for the United States Circuit Court of Appeals for the Second Circuit,[2] after quoting with approval certain cases holding that all ambiguous clauses of policies of insurance are to be construed in favor of the insured, observed that "in the light of the well-settled principles of law expressed in these authorities, the contract under consideration must be construed. The cases holding that a surety is a favorite of the law, and that a claim against him is *strictissimi juris*, have no application. Corporations entering into contracts like the one at the bar may call themselves 'Guaranty' or 'Surety' companies, but their business is in all essential particulars that of insurers, who, upon careful calculation of the risks of such business, and with such restrictions of their liability as may seem to them sufficient to make it safe, undertake to assure against loss in return for premiums sufficiently high to make such business commercially profitable. Their contracts are, in fact, policies of insurance and should be treated as such."[3] As has been well said, "the engagements of insurers are not founded in any philanthropic, benevolent or charitable principle; it is purely a business adventure in which one, for a stipulated consideration or premium per cent, engages to make up wholly or in part, or in a certain agreed amount, any specific loss which another may sustain. To grant indemnity or security against loss for a

[1] 57 S. C. 459; 35 S. E. 754.

[2] Tebbetts, *et al.* *v.* Merc. Cr. Guar. Co. of N. Y., 73 Fed. 95; 19 C. C. A. 281.

[3] See Bank of Tarboro *v.* Fid. & Dep. Co., 128 N. C. 366; 38 S. E. 908.

consideration is not only the design and purpose of an insurance company, but is also the dominant and characteristic feature of the contract of insurance."[1] In a recent case in Oklahoma it was stated that "surety companies" occupy the same relationship to the obligee named in fidelity bonds furnished by them that an insurance company does to an injured person and that for this reason such bonds will be measured by the same rule applicable to insurance policies.[2] It goes without saying that under the well-settled principles of insurance law the insurer in contracts of guaranty insurance, by reason of the similarity in many respects of his agreement with that of the surety, *is not entitled to be treated as a favorite of the law.* The doctrine of the United States Supreme Court in Pauly *v.* American Surety Company[3] contains a clear and explicit refutation of the doctrine that the so-called compensated surety is a favorite of the law, in so far as the same may relate to matters of construction. In that case Justice Harlan, speaking for the court, said: "If, looking at all its provisions, the bond is fairly and reasonably susceptible of two constructions, one favorable to the bank and the other favorable to the surety company, the former, if consistent with the objects for which the bond was given, must be adopted and this for the reason that the instrument which the court is invited to interpret was drawn by the attorneys, officers and agents of the insurance company. This is the well-established rule of the law of insurance. The object of the bond in suit was to indemnify and secure the bank against loss arising through any act of fraud or dishonesty on the part of the cashier. That object should not be defeated by any narrow interpretation of its provisions, or by adopting a construction favorable to the company, if there be a construction equally admissible under the terms of the instrument executed for the protection

[1] Commonwealth *v.* Equitable Ben. Ass., 137 Pa. St. 412; 18 Atl. 1112.

[2] Guthrie Nat. Bank *v.* Fid. & Dep. Co. of Md., 17 Okla. 397; 79 Pac. 102. See also U. S. Fid. & Dep. Co. *v.* Ridgley, 70 Neb. 622; 97 N. W. 836.

[3] 170 U. S. 133; 18 Sup. Ct. Rep. 552; 42 L. E. 977.

of the bank. As was said by Lord St. Leonards,[1] 'An indemnity bond is prepared by the insurance company and if, therefore, there should be any ambiguity in it, it must be taken according to the law most strongly against the person who prepared it.'" But in the second case of the same title[2] Justice White in his dissenting opinion therein said: "It is, of course, unquestioned that many authorities hold that where there is an ambiguity in a contract of insurance, a reasonable doubt as to its construction will be resolved in favor of the insured, because the policy is presumed to have been drawn by the officers or agents of the insurer. But granting, *arguendo*, that this rule applies to a contract of suretyship of the character of that under consideration, I know of no case which pushes the principle to the extent of holding that the express provisions of a contract must be destroyed, and thereby a liability be enforced against the insurer not in harmony with the contract, in conflict with its spirit, in violation of the manifest intention of the parties, and productive of great injustice." Since the foregoing was decided, the United States Supreme Court has had the same matter before it for decision in the case of the United States Fidelity and Guaranty Company *v.* United States,[3] and the question was submitted to the court upon the theory (based upon the statements contained in the present text) that the rule that the surety is a favorite of the law has no application to a case where the surety receives compensation and is in the line of its regular business. The court in its opinion in this case in no wise denied the soundness of the rule laid down in the text of this work, but in deciding the case in favor of the defendant in error, preferred to base its decision on the peculiar nature of the covenants contained in the bond sued upon. In its opinion it spoke as follows:

"The question involved is whether the ordinary rule

[1] Anderson *v.* Fitzgerald, 4 H. L. Cas. 484.

[2] 170 U. S. 160; 42 U. S. Sup. Ct. Rep. L. E., p. 987; 18 Sup. Ct. Rep. 563.

[3] 191 U. S. 416; 48 L. E. 242.

that exonerates the guarantor in case the time fixed for the performance of the contract by the principal be extended applies to a bond of this character executed by a guaranty company not only for a faithful performance of the original contract, but for the payment of the debts of the principal obligor to third parties. It is conceded that, by the general law of suretyship, any change whatever in the contract for the performance of which the guarantor is liable, made without his consent, such, for instance, as an extension of time for payment, if made upon sufficient consideration, discharges the guarantor from liability.[1]

Counsel for the Brick Company argued with much persuasiveness that the rule of *strictissimi juris*, though universally accepted as applicable to the undertaking of an ordinary guarantor, who is usually moved to lend his signature by motives of friendship or expectation of reciprocity and without pecuniary consideration, has no application to the guaranty companies, recently created, which undertake upon the payment of a stipulated compensation, and as a strictly business enterprise, to indemnify or insure the obligee in the bond against any failure of the obligor to perform his contract. It is at least open to doubt, however, whether any relaxation of the rule should be permitted as between the obligee and the guarantor, which may have signed the guaranty in reliance upon the rule of *strictissimi juris* and with the understanding that it is entitled to the ordinary protection accorded to guarantors against changes in the contract or extensions of the time of payment.

"The rule of *strictissimi juris* is a stringent one and is liable at times to work a practical injustice. It is one which ought not to be extended to contracts not within the reason of the rule, particularly when the bond is underwritten by a corporation which has undertaken for a profit to insure the obligee against a failure of performance on

[1] Miller *v.* Stewart, 9 Wheat. 681; 6 L. E. 190; Smith *v.* U. S., 2 Wall. 219; 17 L. E. 788; Reese *v.* U. S., 9 Wall. 13; 9 L. E. 541.

the part of the principal obligor. Such a contract should be interpreted liberally in favor of the insured, with a view of furthering the beneficent object of the statute."[1]

To draw just legal conclusions from the foregoing authorities as to the matter before us is by no means an easy matter. Some things, however, appear in this connection too clear to admit of argument. One of these is that the so-called surety company cannot claim at one and the same time the full benefit of both the law of insurance and that of private suretyship.[2]

[1] See also Hill *v.* Am. Sur. Co., 200 U. S. 197.

[2] See the following cases, wherein the compensated surety is treated as an insurer, and not in the same manner as a gratuitous surety: Nat. Bank of Asheville *v.* F. & C. Co. of N. Y., 89 Fed. 819; 32 C. C. A. 355; Sup. Cl. C. K. of Am. *v.* F. & C. Co. of N. Y., 63 Fed. 48; 11 C. C. A. 96; M. K. & T. Tr. Co., *et al. v.* German Nat. Bank, 77 Fed. 117; 23 C. C. A. 65; Fid. & Dep. Co. *v.* Commonwealth, 104 Ky. 579; 47 S. W. 579; F. & C. Co. *v.* St. Matthews Sav. Bank, 104 Fed. 858; 44 C. C. A. 225; Rice, *et al. v.* Fid. Co. of Md., 103 Fed. 427; 43 C. C. A. 270; Bank of Tarboro *v.* Fid. & Dep. Co., 128 N. C. 366; 38 S. E. 908. See People *ex rel. v.* Rose, 174 Ill. 310; 51 N. E. 246; Guar. Co. of N. A. *v.* Mech. Sav. Bank & Tr. Co., 80 Fed. 766; 26 C. C. A. 146; 47 U. S. App. 91; overruled in 183 U. S. 402; 46 L. E. 253; Am. Cr. Indemn. Co. *v.* Athens Woolen Mills, 92 Fed. 581; 34 C. C. A. 161; Jackson *v.* F. & C. Co. of N. Y., 75 Fed. 359; 21 C. C. A. 394; Shakeman *v.* U. S. Cr. Sys. Co., 92 Wis. 366; 66 N. W. 528; Tebbetts *v.* Merc. Cr. Guar. Co., 73 Fed. 95; 19 C. C. A. 281; F. & C. Co. of N. Y. *v.* Eickhoff, 63 Minn. 170; 65 N. W. 351; State *v.* Hogan, 8 N. D. 301; 78 N. W. 1051; Robertson *v.* U. S. Cr. Sys. Co., 57 N. J. L. 12; 29 Atl. 421; Claflin *v.* U. S. Cr. Sys. Co., 165 Mass. 501; 43 N. E. 293; Hayne *v.* Met. Tr. Co., 67 Minn. 245; 69 N. W. 916; Strouse *v.* Am. Cr. Ins. Co., 91 Md. 244; 46 Atl. 328, 1016; Trenton Potteries Co. *v.* Tit. Guar. & Tr. Co., 65 N. Y. Sup. 166; 50 N. Y. App. Div. 490; Minn. Tit. Ins. & Tr. Co. *v.* Drexel, 70 Fed. 194; 17 C. C. A. 56; Gauler *v.* Tr. Co., 9 Pa. Ct. Rep. 849; Wheeler *v.* Tr. Co., 160 Pa. St. 403; 28 Atl. Rep. 849; F. & C. Co. of N. Y. *v.* Yoder, 63 Kan. 880; 64 Pac. 1027; Seaton *v.* Heath, 1 L. R. App. Cas. 1899, 782; Dane *v.* Mortg. Ins. Corp., 1 Q. B. App. Cas. 1894, p. 54; Finlay *v.* Mexican Ins. Corp., L. R. 1 Q. B. App. Cas., 1897, p. 517; U. S. Fid. & Dep. Co. *v.* Ridgley, 70 Neb. 622; 97 N. W. 836; Willoughby *v.* Fid. & Dep. Co. of Md., 16 Okla. 546; 85 Pac. 713; Remington *v.* Fid. & Dep. Co. of Md., 27 Wash. 429; 67 Pac. 989; Carstairs, *et al. v.* Am. Bond. & Tr. Co. of Baltimore, 116 Fed. 449; 54 C. C. A. 85; Champion Ice & Cold Storage Co. *v.* Am. Bond. & Tr. Co., 115 Ky. 863; 75 S. W. 197; Granite Bldg. Co. *v.* Sayville Adminis., *et al.*, 101 Va. 217; 43 S. E. 351; Pacific Nat. Bank of Tacoma *v.* Ætna Indemn. Co., 33 Wash. 428; 75 Pac. 590.

Such a position would be, legally speaking, impossible as well as impracticable in view of the widely diverging character of the contract of the private surety as contrasted with that of the insurer. It would be inequitable as well as illogical to permit the "surety company" to assume at one time the attitude of a strict surety, and as such, when sought to be held liable, to invoke to its aid every principle of law or equity applicable to that relationship; and then at another, to assume the rôle of an insurer and call to its aid all the somewhat refined principles as well as the technicalities of insurance law. The only proper solution of this problem seems to be that adopted by so many courts of high authority; namely, to treat the compensated surety in all cases as an insurer subject in all respects to the general principles of insurance law, modified to a limited extent by the quasi-suretyship nature of the contract arising from the dual relationship sustained by the insurer to the insured and the "risk."[1]

As long as the primary, if not the only, purpose of the "surety companies" in issuing their policies or bonds is to secure a pecuniary benefit for themselves, this fact alone should be sufficient in law to preclude them from asserting such rights of sureties or guarantors as are extended to the latter solely because of their position as favorites in the eye of the law.[2]

On the other hand it must be conceded that the general principles applicable to other classes of insurance are to be applied to the contracts entered into by the so-called "surety companies." Thus the general doctrines of warranty, representation, concealment and conditions as applied to fire, marine and life insurance are alike applicable to guaranty insurance.[3]

§ 5. **The Validity of Guaranty Insurance.** — The general invalidity of guaranty insurance contracts was strongly urged

Roark *v.* C. T. S. D. & Surety Co., Mo. App. 110 S. W. 1.

[1] See U. S. Fid. & Dep. Co. *v.* Ridgley, 70 Neb. 622; 97 N. W. 836.

[2] P. C. C. *v.* St. L. Ry. Co., *et al.* *v.* K. & H. Bridge Co., 107 Fed. 781–788; 46 C. C. A. 639.

[3] U. S. Fid. & Guar. Co. *v.* First Nat. Bank of Dundee, Ill. ; 84 N. E. 670.

before the Supreme Court of Minnesota in the case of Fidelity and Casualty Company of New York *v.* Eickhoff.[1] The court, in passing on the question as there presented, spoke as follows:

"The second point urged is that the contract guaranteeing honesty is void as being against public policy. That it is the duty of all employers dealing with the general public to employ honest agents. That the effect of such a contract as set out in the complaint is to make it a matter of indifference to the elevator company (the insured) whether it employs honest or dishonest agents to deal with the patrons of the elevator. There is nothing whatsoever in this objection. The same principle is involved in every bond executed by a public officer or a private agent as the security for the faithful performance of his duties, and it is wholly immaterial whether the guarantor is a private person or an incorporated guaranty insurance company. The advantages of the latter mode of suretyship, if properly conducted, are very apparent."

In Samuel *v.* Fidelity and Casualty Company of New York[2] it was held that a contract for the payment of money to a "surety company" upon a guaranty insurance policy given to secure the performance of a contract with the United States government was not against public policy. The question was raised by the "surety company," and in passing thereon the court used these words:

"This seems to be a remarkable proposition in view of the business which the defendant claims to be carrying on. It charges a premium for becoming a surety, and when it is sought to be charged where it has entered into such a contract of suretyship, it claims that the payment of money to it was a breach of public policy, and the party cannot recover damages by reason of the breach of its contract. The very business of the defendant itself is embraced within the proposition which it is sought to have the court pronounce to be illegal."[3]

§ 6. **Question of the Applicability of the Statute of Frauds to Guaranty Insurance.** — In considering the question of applicability or non-applicability of the statute of frauds to guar-

[1] 63 Minn. 170; 65 N. W. 351.

[2] N. Y. Sup. 850; 49 Hun, 122.

[3] See also McGay, *et al.* *v.* Leitz, *et al.*, Ga., 56 S. E. 856.

anty insurance contracts, we are approaching a problem of more apparent than real difficulty. It is well settled that the statute of frauds has no application to contracts of fire, life and marine insurance.

As was said by the Supreme Court of Maine in a leading fire insurance case:[1] "There is, indeed, nothing in the nature of a contract of fire insurance which requires to be in writing. The issuing of a policy furnishes a convenient mode of proving the contract, but it is not essential to its validity."[2] But when we approach the domain of guaranty insurance, an element appears which is wanting in life, fire and marine insurance contracts, to wit, the recognition of a possible future legal liability of a principal for which, under certain conditions, the guaranty company agrees to be responsible to the persons in whose favor such liability may exist.[3]

At common law it was not necessary that the contract of a surety or guarantor should be in writing, in order to charge them. This being so, the statute,[4] commonly called the "statute of frauds," was passed. The fourth section of that statute, so far as pertinent to the subject of guaranty insurance, was as follows: "No action shall be brought whereby to charge the defendant upon any special promise to answer for the debt, default or miscarriage of another person, unless the agreement on which such action shall be brought, or some memorandum or note thereof, shall be in writing and signed by the party to be charged therewith, or by some person thereunto by him lawfully authorized." To ascertain whether or not verbal contracts to furnish guaranty insurance come within the statute of frauds, it will be proper at the outset to consider in detail the phraseology of the foregoing section of the statute of frauds above cited.

The words "any special promise" have been held to con-

[1] Walker *v.* Metropolitan Ins. Co., 56 Me. 371.

[2] See Anderson *v.* Sperce, 72 Ind. 315.

[3] See Sweeney *v.* Ætna Indemn. Co., 34 Wash. 126.

[4] 29 Charles II., chap. 3.

fine the statute to actual promises or promises in fact made; that is, express as opposed to implied promises.

The words "debt, default or miscarriage" include torts of the principal as well as breaches of contracts by him, and apply to every case in which one person becomes responsible for another.

Of the words "debt and default" it has been said that they refer to a liability accruing upon a contract, — the word "debt" to such as is already incurred, and the word "default" to such as may be incurred in the future.

The word "miscarriage" it has been said comprehends that species of wrongful act for the consequences of which the law will make the party civilly responsible. The words "of another," found in the statute, contemplate a present or future liability on the part of a principal.

So much, then, for the wording and meaning of the statute before us. The next inquiry is — Has the statute any practical application to contracts of guaranty insurance? In answer to this question we are confronted at the outset with the proposition that the statute of frauds has no application to insurance generally. Is guaranty insurance to be the exception to the rule? A careful consideration of this question leads inevitably to a negative answer. This conclusion is based partly upon an analysis of the contract of guaranty insurance itself, and partly upon an examination of the authorities bearing upon the proposition now before us. The analysis here referred to brings us certain salient features, all of which have a direct bearing upon the question of the applicability of the statute of frauds to guaranty insurance. These are the unquestioned intention on the part of the guarantor (the insurer) to benefit itself by securing a premium; the creation of a new contract between the guarantor and the party guaranteed; the recognition of a future rather than of a present liability, and this invariably a contingent one; the presence of a new consideration, the premium, whether running from the party guaranteed or from the principal himself;

and the direct assumption of a primary liability by the guarantor contemporaneous with the creation of the contract between the principal and the party guaranteed. The rule of law which seems clearly applicable to contracts of guaranty insurance in this connection may be stated as follows: Whenever the contract of guaranty is founded upon a new and valuable consideration, with the immediate object of subserving some pecuniary or business purpose of the guarantor, then such a guaranty is not within the statute of frauds, even though it has the legal effect of discharging the debt of another.

Justice Clifford, of the United States Supreme Court, said in this connection:[1]

> "Whenever the main purpose and object of the promisor is not to answer for another, but to subserve some business or pecuniary purpose of his own, involving either benefit to himself or damage to the other contracting party, his promise is not within the statute, although it may be in form the promise to pay the debt of another, and although the performance of it may incidentally have the effect of extinguishing that liability."

The hazy atmosphere which seems to surround this question in some quarters arises very largely by reason of the concurrent existence of a contract liability of a third party, to secure the faithful performance of which the guaranty policy of insurance is issued to the party in whose favor such liability exists. So, misled by the analogy in facts and circumstances between the situation outlined above and that existing in ordinary cases where special promises to answer for the debt, default or miscarriage of another exist, one is apt to conclude that the statute of frauds is equally applicable in both cases. This is not true, and the misapprehension thus induced may be easily removed by bearing in mind that where the circumstances of transaction — which include an insurance company's guaranty to the insured that the contract obligation of a third party to the latter shall be performed — are such

[1] Slater v. Emerson, 60 U. S. 224.

as to raise any independent legal obligation on the part of the former to see that these contract obligations are faithfully met (such, for example, as the acceptance of the insurance premium), the fact of the existence of an exactly similar obligation on the part of such third party to the insured is immaterial so far as the statute of frauds is concerned. This for the reason that its special purpose is to afford a basis of measurement as to the amount and extent of the insurer's obligation to the insured.

But little else need be said with reference to the application of the statute of frauds to guaranty insurance. Whether the premium is paid by the insured or by the party whose faithful performance of contractual obligations is guaranteed, in neither case is the statute applicable. If paid by the latter, it still constitutes an original undertaking and one which may be enforced by the insured as the real party in interest.[1]

CHAPTER II

PARTIES TO THE CONTRACT OF GUARANTY INSURANCE

§ 7. **Who may be Parties.** — All parties legally capable of entering into contracts may become parties thereto. This well-settled general rule needs no citation of authorities to support it, and what exceptions or modifications thereto exist, will be adverted to later on.

In a strict legal sense, the parties to the contract of guaranty insurance are two in number, who will be referred to herein under the names so familiar in other branches of insurance

[1] See generally as to the applicability of the statute of frauds to guaranty insurance contracts: Bank of Asheville *v.* F. & C. Co. of N. Y., 89 Fed. 819; 32 C. C. A. 355; and F. & C. Co. of N. Y. *v.* Ballard & Ballard Co., 20 Ky. Law Rep. 1169; 48 S. W. 1074; Week *v.* Widgeon, 23 Ind. App. 405; Eisch *v.* White, 76 Minn. 220; Manary *v.* Runyan, 43 Ore. 495; Faulkner *v.* Thomas, 48 W. Va. 148.

law as the "insurer" and the "insured." This nomenclature, however, has not been adopted generally by the courts, which still make occasional use of the terms "obligor" and "obligee," "surety" and "employer," "guarantor" and "guarantee," "indemnitor" and "indemnitee," "common surety," etc. In the present work the words "insurer" and "insured" will be uniformly employed when referring to the parties to the contract of guaranty insurance, and the contract itself will be referred to either as a "policy" or a "bond." This is done for the purpose of assimilating as far as possible in the subject now before us the terminology of general insurance law. Here again there is a noticeable absence of uniformity on the part of the courts in giving a name to the instrument issued by the guaranty companies to the insured. By some it is referred to simply as a "bond"; others refer to it as an "indemnity contract"; while still others refer to it as an "insurance bond" or "guaranty policy." Throughout the present work the terms "policy" and "bond" will be used interchangeably, as identical in meaning and legal effect.[1]

§ 8. **The Insurer Defined.** — The insurer is the party — usually corporate — who to a certain limited extent undertakes, under certain conditions, as designated in the contract entered into between the parties, to indemnify the insured against pecuniary loss arising through the acts of a third party sustaining a contractual relationship to the insured.

§ 9. **The Power of Guaranty Insurance Companies to issue Policies.** — It goes without saying that the right to conduct the business of guaranty insurance in the case of incorporated companies rests entirely upon the powers conferred upon the corporation by its charter. These powers must be clearly expressed in definite language, and must contain, without any forced construction, the right to transact the business of guaranty insurance. Aside from the mere question of its powers

[1] As to terminology, see Bank of Tarboro *v.* Fid. & Dep. Co., 126 N. C. 320; 35 S. E. 588; 38 S. E. 908.

in this regard, as evidenced by the charter, such corporation, being engaged in the business of insurance, is governed by the laws of the several states relative to the prosecution of an insurance business by either domestic or foreign insurance companies. Then it becomes a question of special authority.[1]

In most if not all the states of the union statutes have been enacted principally for the protection of policy-holders, prescribing the conditions upon which insurance companies and societies will be permitted to organize and transact business within the state, and these apply to both domestic and foreign corporations. The power of the state to enact such laws is inherent so long as corporations like natural persons are subject to the local laws which may be enacted. Sometimes this power to regulate is carried to the extent of prescribing the form and limiting the conditions of the policies issued by insurance companies.[2]

§ 10. **The Insured Defined.** — The insured is the party to the contract of insurance to whom the policy is issued and to whom the loss if any is payable. It is mainly for his benefit that perils are assumed and that indemnity against them is provided. With the possible exception of contract bonds, the real party in interest, and the one for whose benefit such bond is issued, is specifically named therein as the insured. Indeed, in most cases the recital of the name of a party in the application for the policy as the insured would, in the absence of fraud or mistake, preclude a showing that a different party than the one named in the policy as the insured was intended as the beneficiary of such insurance; this for the reason that

[1] See *in re* Altoona & B. C. Ter. Ry. Co.'s Bond, 24 Pa. Co. Ct. 561.

[2] See on the general subject of power to transact a guaranty insurance business, People *ex rel. v.* Rose, 174 Ill. 310; 51 N. E. 246; People *ex rel. v.* F. & C. Co. of N. Y., 153 Ill. 25; 38 N. E. 752; People *ex rel.* Nat. Sur. Co. *v.* Feitner, 166 N. Y. 129; 59 N. E. 731; U. S. Fid. & Guar. Co. *v.* Linehan, 47 Atl. 611; Bank of Tarboro *v.* Fid. & Dep. Co., 38 N. E. 908; 128 N. C. 366. *In re* Clarks Estate, 195 Pa. St. 520. As to special authority of agent to execute policies in behalf of a surety company, see Pacific Nat. Bank *v.* Ætna Indemn. Co., 33 Wash. 428; 74 Pac. 590.

the contract is a personal one. But in the case of judicial and contract insurance the matter is in some jurisdictions worked out into harmony with guaranty insurance principles, on the theory that the nominal insurer in such policies is in fact a trustee for the real beneficiaries, who may or may not be determined when the policies are issued.[1]

§ 11. **Who may be insured.** — The right to apply for and receive the benefits of guaranty insurance is open to all parties possessing the necessary insurable interest hereinafter referred to. This includes private individuals, whether adults or infants, married or sole, copartnerships, societies, corporations, private, public or eleemosynary, and extends to all governmental agencies such as municipal organizations, cities, townships, counties, states and national governments.

Thus it has been expressly held that an infant may enter into a contract of insurance so as to make it obligatory as to the insurer, though voidable as to him.[2] So, too, it has been held that the power to take guaranty bonds or policies is inherent in every corporation, whether public or private, independent of statute.[3] This principle applies as well to religious as to private and public civil corporations. To all such corporate bodies the same equitable doctrines and rules apply.[4]

Indeed it cannot be claimed at this late day that either public corporations or private corporations have not the power to accept policies of guaranty insurance. The defence of *ultra vires* cannot be successfully urged by the insurer as against the insured corporation under such circumstances, so long as the latter has power to make the contract to secure the faithful performance of which the policy may have been issued. Then it has the undoubted right to secure such faithful performance in any proper manner, one of which is

[1] See *post*, § 178.

[2] See Monaghan *v.* Agri. Fire Ins. Co., 53 Mich. 238; 18 N. W. 797.

[3] Am. Sur. Co. *v.* Lauber, *et al.*, 22 Ind. App. 326; 53 N. E. 793.

[4] N. Ev. Luth. B. Cong. *v.* U. S. Fid. & Guar. Co., 81 Minn. 32; 83 N. W. 487.

to require parties contracting with it to provide a policy of guaranty insurance for its benefit. Such corporations not only have the powers expressly granted to them, but they have also certain implied powers necessary for the carrying out of those that are expressly granted.[1]

§ 12. **The Law of Agency as affecting the Mutual Rights and Obligations of the Parties to contracts of Guaranty Insurance.** — It is no part of the purpose of the present work to enter into an exhaustive treatise on the law of agency in its relation to contracts of guaranty insurance. With some few exceptions, which will be carefully pointed out from time to time in their proper place, the subject of guaranty insurance is controlled by exactly the same principles in relation to the application of the law of agency as exist in other and better known branches of insurance law.[2] To such as have occasion to investigate the subject at length reference should be had to works on agency or to works on general insurance law.[3]

§ 13. **The "Risk."** — In the definition of guaranty insurance already given, reference is made to the existence of a personality sustaining a contractual relationship with the insured, and who is in a personal sense himself the subject-matter of the insurance contracted for. It is this personality which is referred to throughout this work as the "risk." In the case of fidelity insurance it is represented by the party whose faithful performance of duty while occupying a fiduciary relationship to the insured is guaranteed, to a limited extent at least, by the furnishing of the insurance bond or policy.

Turning now to the various branches of commercial insurance, it may be said that as to contract insurance the "risk" there is represented by the party whose performance of simple

[1] Am. Sur. Co. *v.* Raeder Ass., *et al.*, 15 Ohio Cir. Ct. 471.

[2] Getchell & Martin Lumber Co. *v.* Peterson & Sampson, 124 Ia. 599; 100 N. W. 550; Davis *v.* Pullman Co., 34 Texas Cir. App. 621.

[3] As to right of agent to execute policy in behalf of a surety company, see Pacific Nat. Bank *v.* Ætna Indemn. Co., 33 Wash. 428; 74 Pac. 590.

contract obligations is secured by the insurance bond or policy; in credit insurance it is the debtor to whom credit has been extended, by the insured who impersonates the "risk"; while in title insurance it is, in a sense at least, the grantor from whom the insured has purchased real property.

In judicial insurance the "risk" is represented either by the appointee of the court, to secure whose faithful conduct the insurance bond or policy is executed, or else by the principal, whose performance of the terms of his undertaking as given in the course of judicial or quasi-judicial proceedings is secured by the issuance of a judicial insurance bond.

Throughout this entire work care must be taken not to confuse the "risk" with the perils insured against. The "risk" in guaranty insurance has in all cases exclusive reference to a personality whose conduct, either by way of misfeasance or non-feasance, alone constitutes the perils insured against. In most forms of insurance the risk is synonymous with the perils insured against, but in guaranty insurance that is not true. Owing to the fact that in the last-named branch of insurance the perils insured against are invariably impersonated, not in the actions of the lawless and uncontrollable forces of nature, but in the action of man as a responsible human agent, the term "risk" here has reference to a human personality whose conduct along certain designated lines constitutes the perils insured against. Thus it appears that the term as herein used relates solely to a personality entering into contract obligations, and possessing contractual rights which the courts will recognize and enforce.

The word, when employed in such a connection, has no reference whatever to the extent of the insurer's obligations, which, as has been pointed out, is its more common meaning. The term "risk," as herein used, may, therefore, be defined to be the person named in a contract of guaranty insurance whose faithful discharge of certain specified contractual obligations to the insured is guaranteed in the form of an indem-

nity obligation entered into by the insurer in favor of the insured. The nomenclature here adopted has been quite generally adopted by both the surety companies and the courts.[1]

The "risk" must of necessity be under some contract obligations to the insured, the violation of which would cause pecuniary damage to the latter. It is in general essential, in order to render the insurer liable on the policy, that the damage so caused should be one for which the "risk" would himself be personally liable to the insured.[2]

While it has already been stated that the parties to guaranty insurance contracts are two in number, it might be argued, and with no little force, that there is yet a third party to the contract, who is represented by the "risk." The latter considered individually and apart from the perils incident to wrongful conduct on his part, in relation to the performance of certain obligations due the insured, is in reality a quasi-beneficiary of the contract of insurance. As such it then becomes a question whether his relation to, and interest in, the policy issued at his request, for the more direct benefit of the insured, gives to such "risk" the right to be deemed a party to the contract. In answer to the foregoing query it is sufficient to say that it has not so far been the policy of the law to give the "risk" any substantial recognition whatsoever in the capacity of a party to the insurance agreement. The defining of the exact legal relationship sustained by the "risk" respectively to the insured and the insurer has not at all times been performed by the courts with entire success. But certain principles may now be regarded as settled: (1) That the "risk" is not ordinarily a party to the contract of insurance.[3]

[1] See *e.g.* Bryant *v.* Am. Bond. Co., 76 Ohio 90; 82 N. E. 960.

[2] See §§ 15, 113, *post.* See also Blades *v.* Dewey, *et al.*, 136 N. C. 176; 46 S. E. 626; Champion Ice & Cold Storage Co. *v.* Am. Bond. & Tr. Co., 115 Ky. 863; 75 S. W. 197.

[3] Am. Bond. & Tr. Co. *v.* Mil. Harv. Co., 91 Md. 733; 48 Atl. Rep. 72; Iowa L. G. Min. Co. *v.* Bliss, *et al.*, 144 Fed. 446.

(2) That as between the insurer and the "risk" the relationship of principal and surety exists.[1]

(3) That as between the insured and the "risk" some contractual relationship must exist, upon which may be predicated certain existing or contemplated property rights, enforceable in law against the latter by the former.[2]

(4) The respective liability of the insurer and the "risk" to the insured is not a joint obligation, but is several, and each rests upon distinct and separate grounds.[3]

(5) In the case of official bonds signed by both the "risk" and the insurer, the "risk" is a proper party defendant in any action brought by the insured against the insurer to recover for alleged defalcations of the "risk" under the bond.[4] The rule appears to be different in the case of private bonds.[5] While it is true that the "risk" not infrequently joins with the insurer in subscribing his name to the policy issued, this is not done with the purpose of making him a party to the insurance contract entered into between the insurer and the insured, but with the intent of evidencing in this formal manner his consent to its terms, and his promise to indemnify the insurer.[6]

§ 14. **Who may become a "Risk."** — Any person may become a "risk" and his proper conduct or faithful execution of trust or contract guaranteed in the form of an indemnity insurance bond running from the insurer to the insured, provided he sustains such a contractual relationship to the latter

[1] Rice *v.* Fid. & Dep. Co., 103 Fed. 427; 43 C. C. A. 270.

[2] U. S. Fid. Co. *v.* Ridgley, 70 Neb. 622; 97 N. W. 836; Iowa L. G. Min. Co. *v.* Bliss, *et al.*, 144 Fed. 446; U. S. Glass Co. *v.* Matthews, 80 Fed. 828; 32 C. C. A. 364.

[3] Iowa L. G. Min. Co. *v.* Bliss, *et al.*, 144 Fed. 446; see also Cochran & Fid. & Dep. Co. *v.* Montgomery Co., 199 U. S. 260; 50 L. E. 182; *Idem*, 57 C. C. A. 261; 121 Fed. 17; 62 C. C. A. 70; 126 Fed. 456; 62 C. C. A. 680; 128 Fed. 1019; 116 Fed. 985.

[4] *Idem*, Cochran & Fid. & Dep. Co. *v.* Montgomery Co., *ante;* Iowa L. G. Min. Co. *v.* Bliss, *et al.*

[5] Iowa L. G. Min. Co. *v.* Bliss, *et al.*, 144 Fed. 446.

[6] Am. Bond. & Tr. Co. *v.* Mil. Harv. Co., 91 Md. 733; 48 Atl. 72; Guar. Co. of N. A. *v.* Mech. Sav. Bank & Tr. Co., 80 Fed. 766; 26 C. C. A. 146.

as renders obligatory the faithful performance of the obligations concerning which the insurance is issued. Even disability to contract on the part of the "risk" by reason of infancy, insanity, guardianship or some other cause, will not, it is believed, prevent such a one's becoming a proper "risk" in guaranty insurance to the extent of invalidating the contract entered into between the insurer and the insured.[1]

The controlling principle seems to be that if the contract entered into between the insured and the risk is merely voidable and not void, as for example on account of the infancy of the risk, this fact in itself does not suffice to relieve the insurer from liability under his contract with the insured or to constitute the purpose in any form, and if the invalidity of the risk's contract with the insured rests upon reasons personal to the risk in the nature of a privilege or protection, this even though the risk acquires a personal defence under the contract against the insured, nevertheless, the contract itself suffices, and the insurer is still chargeable under the policy which it has issued.[2]

§ 15. **Reasons for the Rule requiring a Contract Relationship by the "Risk" with the Insured.** — As the purpose of all guaranty insurance is indemnity it would be foreign to such professed object to admit of policies being issued upon "risks" sustaining no contractual relationship to the insured. In fact, if the rule were not as stated, the door would be thrown wide open for wagering contracts and speculation, in direct convention of well-recognized rules of public policy. On the other hand, if this distinctive contractual element were not insisted upon, the tort features which more properly belong to accident or liability insurance might appear. As a matter of fact and practice insurance bonds are invariably so as to make the existence of such contractual relationship a condition precedent to any recovery thereunder. It is this

[1] See, as bearing on this question, Monaghan *v.* Agri. Fire Ins. Co., 53 Mich. 238; 18 N. W. 797.

[2] See Smyley *v.* Head, 2 Richardson Law, S. C. 590; Winn *v.* Sandform, 145 Mass. 302.

contractual relationship which affords the insurable interest necessary to support the contract itself.[1]

A fact that may be stated as a general principle governing all branches of guaranty insurance is that every contract of compensated suretyship is based upon some contract made or obligation assumed by the "risk," and the liability of the compensated surety thereunder is measured in all cases by the obligation of the "risk" to the party for whose benefit such contract of compensated suretyship was entered into.[2] The obligation of the insurer to the insured can never be greater than the liability of the "risk" to the insured.[3]

[1] See § 30, *post;* also Iowa L. G. Min. Co. Ltd. *v.* Bliss, *et al.*, 144 Fed. 446; Independent School District *v.* Hubbard, 110 Ia. 68; 81 S. W. 241.

[2] Blades *v.* Dewey, *et al.*, 136 N. C. 176; 48 S. E. 626. See also Rochester *v.* Campbell, 123 N. Y. 405; 25 N. E. 937; Groendyke *v.* Musgrave, 123 Ia. 535; Roth *v.* Adams, 185 Mass. 341; Little *v.* Bradley, 43 Fla. 402; Wicker *v.* Hoffock, 6 Wallace U. S. 94; 18 L. E. 752.

[3] Fid. & Dep. Co. *v.* Schelper, *et al.*, Tex., 83 S. W. 871.

PART II. — FIDELITY INSURANCE

CHAPTER III

INTRODUCTORY REMARKS ON FIDELITY INSURANCE

§ 16. **Definition and Scope of Fidelity Insurance.** — Fidelity insurance is a form of guaranty insurance whereby, for a valuable consideration, one party, termed "the insurer," agrees to indemnify another, termed "the insured," in a designated amount against loss arising through the fraud, dishonesty or unfaithfulness of a third party (hereinafter designated as the " risk ") sustaining a fiduciary relationship to the insured.[1]

The term " fiduciary relationship," as used in the foregoing definition, is to be given a broad and liberal interpretation, embracing positions of both private and public trust.[2] It covers cases not only of express technical trusts, but also relates to the execution of trusts springing from contract. It includes also parties holding elective or appointive official positions outside the domain of the courts. Within the broad scope thus outlined are embraced guaranty insurance bonds covering bank officials, street-car conductors, railroad conductors and ticket agents, express agents, telegraph and telephone operators, insurance agents, clerks, collectors, treasurers and cashiers, corporate officers of all grades and character, bookkeepers and employees in mercantile houses, national, state, county, township and city officials, notaries public, etc.

§ 17. **Proposals and Applications for Fidelity Insurance Bonds.** — A custom almost universal in extent has sprung

[1] Cowles *v.* U. S. Fid. & Guar. Co., 32 Wash. 120; 72 Pac. 1032.

[2] See Robinson *v.* Hope, 57 Cal. 493; Marston *v.* Gould, 69 N. Y. 220; Smith *v.* Ogilvie, 127 N. Y. 143.

up among the fidelity insurance companies of requiring, as preliminary to the issuance of fidelity insurance bonds, the presentation to them of formal written proposals and applications therefor, signed respectively by the prospective " insured " and " risk."

In explaining the meaning of these terms it may be said that a proposal in guaranty insurance has reference to a request made by the insured prior to the completion of the contract, looking toward the issuance to him of a policy of insurance by the insurer on some designated " risk " in manner and form as outlined in such proposal.

The application, on the other hand, is a term properly referable to the request (usually concurrent in point of time with the proposal of the insured) made by the " risk " himself, asking that an insurance policy be issued to the insured by the insurer, providing for indemnity against certain perils incident to his fiduciary relationship to the former, as therein designated.

§ 18. **Purpose of requiring Proposals and Applications.** — The underlying purpose on the part of insurance companies doing a fidelity business in requiring applications from the " risks " as well as proposals for bonds of guaranty insurance from the insured is to ascertain the exact position of the former with reference to the perils to be assumed and how far his circumstances as thus disclosed will expose him to temptation. Another purpose is to see that there are sufficient checks provided for detection of fraud, dishonesty or unfaithfulness, so that negligence on the part of the insured will not serve of itself as a temptation.

Still again, the object is to ascertain, by a knowledge of the " risk's " antecedents and business history, together with an acquaintance with his present surroundings and ties, his value as a moral hazard, and the extent or absence of opportunity for fraud or dishonesty on his part. The very fact that the contract about to be entered into is one of insurance, and as such is based on the doctrine of average, renders this

entire subject of proposals and applications one of great importance in fidelity insurance. The contract implies that the risk will have the opportunity to commit fraudulent and dishonest acts, and this leaves it for the insurer to determine first, whether, on the facts as presented by the proposal and application, he cares to assume the liability at all, or if so, at what premium.

An "employer's statement" or proposal, as it is here termed, is required from the employer in connection with all applications for bonds of indemnity in any fiduciary capacity.

A separate blank is provided by the surety companies for this purpose and must always accompany the application.

It is essential that all the questions on this form be answered in full, in order that the bond may be properly drawn up and the surety company informed as to what knowledge the employer has regarding the character and standing of the employee.

It is also necessary that particulars of any previous default on the part of any employee, if such has occurred, shall be given, together with the methods since adopted to prevent similar loss in the future.

The entire system of accounting should be fully disclosed in order that loose methods, if any, may be corrected at once and every proper safeguard and precaution taken to reduce the opportunity for fraud to a minimum. A leading fidelity underwriter of New York has stated that "environment" has much to do with defalcations — a lack of frequent audits, failure to require countersignatures on checks and laxity of business methods may also have something to do with them.

If the accounts of the applicant have not been recently audited, a thorough examination should be required prior to the issuance of the bond, and, in any event, a statement must be made giving the date of the last audit, certifying that everything was found correct at that time.

This statement must be signed by the employer. Where it is signed by an officer or some one else on behalf of the firm

or corporation to whom the bond is to be given, the person signing must be fully authorized and empowered to bind his principal.

§ 19. **The Proposal.** — The proposal for a fidelity insurance policy is usually in the form of a printed letter prepared by the insurer, but addressed to it by the insured, with space therein for answers to a large number of inquiries relative to the insurance sought for, stating that the " risk " has already applied to the insurer to become his security in a designated capacity to a certain amount, and that the information is sought as a basis for the granting of the request for the policy desired. These inquiries relate first to the name and composition of the insured, and his business or occupation. This is accompanied by a statement as to whether or not the " risk " has been in previous or continuous service of the insured, and if so, in what position. Finally, there is a statement of the amount of security required, the time the same is to take effect and the designation of the party by whom the premium is payable. In view of the importance of the inquiries inserted in this proposal, and the answers thereto, in relation to the doctrine of warranty and representation in the law of guaranty insurance, it has been deemed best to insert here a very full statement of the character and nature of the inquiries so propounded. For this reason the following specific inquiries, very generally employed by guaranty insurance companies in connection with applications for policies on " risks " in positions of private trust," are herewith presented without substantial abbreviation:

"*Q.* 1. If only recently employed by you, by whom was applicant introduced, or how did he become known to you?

"*Q.* 2. What further security, if any, will be held or required for applicant?

"*Q.* 3. Has the party hitherto filling this position furnished security?

"*Q.* 4. Has the applicant, to your knowledge, been refused the issue or continuance of a policy in this service by any company or association?

"*Q.* 5. Have you hitherto held other security from applicant? If so, of what kind, and why is it discontinued or changed to this?

"*Q.* 6. Is he now or has he been from any cause in arrears or indebted to the employer or any official thereof?

"*Q.* 7. Has the applicant, to your knowledge, any outstanding debts or liabilities?

"*Q.* 8. Are you aware of the applicant ever having been in arrears or default in any former occupation, or of anything in his past character or habits which might affect his title to confidence?

"*Q.* 9. Is he now or about to be engaged or interested in any other business or employment than in this service?

"*Q.* 10. If paid by salary, state annual amount and when payable. Will salary be subject to fine or reduction?

"*Q.* 11. Has there been any default by any employee holding a similar position in your service?

"*Q.* 12. At what date and by whom were all the funds and accounts of the applicant's office last audited?

"*Q.* 13. Please define nature of applicant's duties. (If there are by-laws or rules governing the office, attach copy.)

"*Q.* 14. Will he, at any time, hold power of attorney on behalf of the employer and if so, for what purpose?

"*Q.* 15. Will he be authorized to indorse checks or drafts otherwise than for deposit to employer's credit in bank?

"*Q.* 16. Will he be authorized to sign negotiable paper of any kind on behalf of the employer?

"*Q.* 17. From what sources will he receive money or valuables?

"*Q.* 18. How often and to whom will he remit or pay over money received?

"*Q.* 19. Will he be required to make disbursements, and if so, for what purposes?

"*Q.* 20. How often and to whom will he report the transactions of his office?

"*Q.* 21. How often will the books be balanced and closed and a statement or trial balance be rendered therefrom? By whom will these statements be examined and verified?

"*Q.* 22. Will the applicant be required to prepare or draw checks on the employer's bank account? Will checks be uniformly countersigned after signature by him, and if so, by whom?

"*Q.* 23. At what intervals will his books, accounts and vouchers be personally inspected and audited, and all moneys or values reported as due, on hand, or in bank, be examined and verified? By whom will this be done?

"*Q.* 24. Will he receive remittances from parties on current accounts?

"*Q.* 25. Will applicant's duties involve the handling or care of securities or treasury assets belonging to the employer?

"*Q.* 26. Will the applicant be charged with the custody or sale of merchandise for the employer; if so, of what kind and what will be the maximum value at his disposition at one time?

"*Q.* 27. What assistants or subordinates (if any) will participate in handling the funds of the applicant's office? Are they under bonds?

After the foregoing inquiries are answered, it is customary to add thereto the following statement over the signature of the insured:

"The foregoing answers, statements and representations are hereby warranted to be true and correct, and it is hereby agreed on behalf of the insured, in consideration of the execution of said policy, that throughout the continuance thereof, the checks and supervisions above described shall be faithfully observed, and that the business of the insured shall continue to be managed and conducted as above set forth. The above answers, statements and representations are to be considered warranties and they shall form the basis of the guaranty herein applied for."

§ 20. **The Application.**—The application on the part of the "risk" to the insurer for the issuance of a guaranty insurance bond is, as a matter of practice, made almost universally upon printed forms prepared by the insurer and forwarded to the "risk" for his signature. It contains questions to be answered by the "risk," which are usually of the same general nature and character both in this country and in England. The application in the first instance states the amount of the policy required, the name of the insured and the general character of the liability to be insured against. In addition to these the application customarily contains inquiries with reference to the age and place of birth of the "risk"; whether married or not; his business history and financial resources, including a statement of debts and liabilities of every nature and description; existence of judgments standing against him; membership in social or secret organizations; amount of life insur-

ance carried, if any; whether or not the "risk" has been in arrears or default during any previous employment; amount of salary to be paid in the position thereafter assumed with the insured; the basis of the remuneration, if any other than that of salary; names of assistants, if any, who participate in the handling of funds or goods belonging to the insured, together with statement as to whether he has ever given bonds while holding previous positions of trust.

Another question is that relating to the "risk's" having theretofore applied for a policy from any other guaranty insurance company, and whether or not such application was refused or accepted. To the foregoing is customarily annexed an agreement that, in case the application is approved, and a policy issued, the "risk" will reimburse the insurer for any damage that it may incur by reason of the issuance of such policy, together with a waiver of any claim for damage that may ensue by reason of the refusal of the insurance company to issue the policy applied for.

The application, in order to become legally a basis for the issuance of the guaranty policy applied for, must be and is accompanied by a statement over the signature of the insured to the effect that the replies of the "risk" in the aforesaid application are to the best of the insured's knowledge and belief correct. To this is sometimes annexed a brief history of the "risk's" previous services, if any, with the insured, accompanied by a statement that the latter has "to the best of the insured's knowledge and belief given satisfaction in his personal conduct and in the performance of duties, and kept his accounts faithfully and without default, and that when last examined or audited, all of said accounts were found in every respect correct. That he has not been, nor is he at present to the insured's knowledge and belief, in arrears or in default, nor is there any unsettled balance in the service referred to or in any previous service; that the insured knows nothing about the "risk's" habits or antecedents affecting his title to confidence, and that the insured knows

of no reason why the guaranty applied for should not be granted."

§ 21. **Are Proposals and Applications Part of the Policy.** — It often becomes important in construing policies and in determining the force and effect of the statements contained in either the proposal or application, to ascertain whether the latter are parts of the policy itself. In this connection it may be safely said that a clear purpose, unequivocally expressed, manifested from either the wording of the proposal or application or from the terms of the policy itself, to make such application or proposal part thereof will have the effect in law to make them such; but where the reference to the application is expressed to be for another purpose, or where it is not clearly expressed that it is intended to make the application a part of the contract, the courts are not inclined to make it so by construction.[1]

Sometimes, to avoid all questions, it is expressly provided in the contract entered into between the parties that "this policy and the application and proposal therefor, copies of which are hereto attached, shall, taken together, constitute the contract of insurance between the insurer and the insured and shall be construed accordingly."

In general the proposal and application jointly form the basis of the contract which is to follow and it is in reliance upon these that the insurance policy is customarily issued. It should, however, be carefully borne in mind that, when referred to in the policy, in such a manner as to make a reference to them necessary to complete the contract of insurance, they then become part and parcel of it.[2]

In general it may be said that where answers to questions and the representations contained in an application for a bond of indemnity against the dishonesty of an employee of the insured were expressly declared to form the basis of the

[1] Columbian Ex. Sal. Co. *v.* Union Cas. & Sur. Co., 123 Ill. App. 245.

[2] Model Mil. Co. *v.* Fid. & Dep. Co., 1 Tenn. Ct. App. 365; M. J. W. Brokerage Co. *v.* Fid. & Dep. Co., La. 44 Sou. 449.

proposed contract of fidelity insurance, such answers and representations become *ipso facto* part of the policy itself.[1]

It has been held that in an action by the insured against the insurer under a fidelity bond, where the defence of the insurer was based upon alleged breach of warranties contained in the written statement by the insured, the answers to questions which the latter expressly agreed should be taken as conditions precedent and as the basis of the policy, that such written statement though torn and mutilated was admissible in evidence on behalf of the insurer where its presence tended to show that the mutilation was accidental, and where the contents of the main part were approved by the insured and admitted by the insurer.[2]

Finally it may be said that the question as to whether or not proposals or applications are part and parcel of the policy which is afterwards issued in response thereto is in its last analysis always a question of intent. On this general subject a federal court recently spoke as follows:

"Although differing slightly from the usual form of applications for insurance in that it recites that an application for the bond had already been made, nevertheless the instrument is to all substantial intents and purposes a part of that preliminary step on the part of the applicant that is usually designated by that term. It contains various questions concerning the "risk" propounded by the defendant. The plaintiff answers and it was recited that it was to be the basis of the bond in suit. The bond contains a reference to it as part thereof, and a warranty by plaintiff of the truth of its statements and the provision that untruth in any respect shall make the bond void. It is then clear that the written statement which the defendant failed to attach to or insert in the bond is an application or representation within the meaning of the Iowa statutes." [3]

§ 22. **What constitutes Acceptance of Proposals and Applications for Policies ?** — Generally speaking, the delivery of

[1] Young *v.* Pacific Sur. Co., 137 Cal. 596; see also Fid. & Dep. Co. of Md. *v.* Courtney, 186 U. S. 342; 46 L. E. 1193.

[2] Waring *v.* U. S. Fid. & Guar. Co., 24 Dis. of Col. App. 119.

[3] U. S. F. & G. Co. *v.* E. S. S. & F. Co., 148 Fed. 353.

the policy and its acceptance by the insured creates a valid contract of insurance binding on both the insured and insurer.

An application or proposal for insurance only becomes a binding contract when the insurer signifies its acceptance thereof. So there must be an acceptance in law, or some act must be done equivalent thereto in legal effect and from which the insurer cannot recede without liability. It may be added that it is always a question for the jury whether an application or proposal has been in fact accepted.

If an application for insurance does not set forth all the conditions which the policy is to contain and the agent acting within the scope of his authority represents that the policy will contain certain lawful stipulations, the policy must contain them, or the insured will not be bound to accept them. So, also, where the policy issued does not conform in terms to the proposal, there is no obligation resting upon the applicant to accept it. In any event, however, it is incumbent upon the insured, in case he wishes to make good his claim that the policy issued does not conform in terms to his proposal, to immediately, upon receipt thereof, notify the insurer of his refusal to accept the same. However, the possession of the policy by the insured is only *prima facie* evidence that it was actually delivered and accepted in a legal sense.

Delivery of the policy is not, however, essential to render it effective where there is a valid contract of insurance already made. So if the contract of insurance is otherwise complete, and the parties intend that it should be effectual without the policy's being actually delivered, then actual or manual delivery is unnecessary. Again, it may be observed there is no obligation resting upon the insurer to accept the proposal or application for guaranty insurance. Therefore, delay in acting thereon will not in itself warrant the presumption of acceptance. In brief, the proposal and application for insurance, whether they be oral or in writing, must be accepted before they become binding contracts. There must be an

actual acceptance thereof, some act to bind the insurer, or some act must be done which is equivalent thereto and from which the insurer cannot recede without liability. If so, there has been an acceptance and the contract is complete.

In any event, an acceptance of the policy by the insured will bind the insurer. The solution of questions relative to the acceptance of proposals or applications for insurance may, in very many cases, be referred to the principles of agency.

In case of absolute guaranties — to which all guaranty insurance contracts belong — no notice of acceptance is necessary. This is one of the broad distinctions that is said to exist between ordinary cases of suretyship and guaranty insurance. So again, where provisional contracts for insurance are entered into by giving to the insured what are termed "guaranty provisional receipts," a full and complete contract of insurance continues in existence until such contract is in express terms revoked by the insurer. And any obligation or liability that may have been incurred meanwhile must be met and satisfied as in ordinary cases.[1]

Questions of considerable difficulty frequently arise relative to the power of general or special agents of surety companies to execute bonds in behalf of their principals. In this connection attention is called to case of Pacific National Bank of Tacoma *v.* Ætna Indemnity Company.[2] In this case a letter of attorney addressed to the general agent of a surety company empowered the latter to execute bonds, guaranteeing the fidelity of persons holding places of public or private trust as well as the performance of contracts other than insurance policies. A bond was issued guaranteeing the performance of a contract by S. as a trustee for another and stipulated that the bond should not be valid until signed by the district agent. The evidence, however, showed that the general agent of the surety company had had the stipulations printed on the bond of his own motion and that the requirement was not

[1] See Hall *v.* U. S. F. & G. Co., 77 Minn. 24; 79 N. W. 590.

[2] 33 Wash. 428; 74 Pac. 590.

made by the general officers of the surety company. The general agent personally induced the insured to incur obligations on behalf of S. as trustee, giving a bond as indemnity, and delivered it himself, having in the meanwhile secured S.'s signature merely as a matter of form. The court held that the power conferred in the letter of attorney to the general agent fully authorized the execution of a bond guaranteeing the performance of a contract to pay money advanced to a building contractor. It was even held that the bond became effective without S.'s signature and was not invalid on the theory that the insured acted as agent for both the risk and the insurer. The court even went so far as to say that even were S.'s signature necessary the general agent of the surety company was acting within the scope of his authority and that his consent to waiving S.'s signature must be admitted to have been with the knowledge and consent of the general officers of the surety company. The particular theory upon which the court delivered its opinion, as stated above, was that the general agent having acted in the belief that by the issuance of the bond the surety company would be saved a loss upon a prior bond by means of advancements made thereunder, the surety company was for this reason estopped to assert that it did not consent to S.'s signature.

§ 23. **Is the Insurer under any Obligation to accept either an Application or Proposal for a Policy?** — The question here presented is not quite as trivial as it may seem on its face to be. For in the case of the "risk," at least, the refusal to issue the policy requested may result in much hardship, or even real injury, to his character and business reputation. In a certain sense the declination by the insurer of his application may be construed as a reflection on him, and may not improbably result in present loss of occupation, and render it well-nigh impossible for him to secure other positions of a similar nature in the future. However this may be, the case is at best but a fair example of the legal principle *damnum absque injuria.*

In support of this statement attention is called to a New York case in which the following facts appeared:

"Before Alfred Ginsberg could secure employment with F. Hollender and Company as a salesman and collector he was obliged to furnish them with a fidelity insurance policy. This was obtained from the Union Surety and Guaranty Company, but the latter, before issuing the same, satisfied itself as to Ginsberg's honesty by correspondence with five persons named by him. Ginsberg had been in the employ of the Hollender Company only a few days when it notified the "surety company" in writing that the new employee had failed to account for certain moneys collected by him, and had failed to call and explain, notwithstanding that he had been requested to do so. The Hollender Company stated that it looked to the "surety company" to make good the loss. An investigation was made by the latter, and when it had satisfied itself as to the truth of the charges against Ginsberg, letters were sent to those who had certified to his character and integrity. These letters, after reciting the facts and stating that it was owing to the favorable indorsement of Ginsberg by the persons addressed, continued, 'In view of these conditions, we will be greatly obliged if you will give us such information as you have or may be able to obtain which may aid us in locating the defaulter.' Subsequently Ginsberg was found, and in time he paid the Hollender Company the money he had collected for it. In an action for libel brought by Ginsberg against the "surety company" in which he recovered a verdict of three hundred dollars, the appellate division of the New York Supreme Court ordered a reversal, holding that the defendant's motion to dismiss, on the ground that the letters sent by it were privileged communications, and no malice had been shown, should have been granted. Justice McLaughlin, for the court, after saying that the communications were privileged, and were sent in good faith, observed that for this reason, 'the plaintiff was not entitled to recovery unless he produced evidence from which a jury might find that the communication was not sent in good faith, but, on the contrary, was sent with the intent and for the purpose of injuring the plaintiff; in other words, that it was malicious. The persons to whom the communications were sent, as already indicated, were the ones whom the plaintiff informed the defendant would, and who have certified to his integrity. It was on the strength of previous communications from the same persons that the plaintiff had obtained the bond of indemnity which enabled him to secure employment with the Hollender Company, and such persons, having been instrumental in inducing the defendant to

execute the bond, were properly notified of the plaintiff's failure to comply with its conditions. Under such circumstances the law does not imply malice from the fact of the publication. Something further must be proved, and that is malice, either express or implied, which must be the incentive to the publication." [1]

Even in the absence of the agreement usually contained in the application to the effect that the guaranty company shall have the right to withdraw or cancel any surety bond previously issued, as well as the right to refuse the issuance of the policy applied for, no action for damages can be maintained, either by the prospective "risk" or the insured, on account of the refusal by the insurer to issue the policy requested.

In Hunt *v.* Simmond[2] an action was brought for damages alleged to have been sustained through a conspiracy on the part of several insurance companies whereby the plaintiff was refused insurance on his vessels, all as alleged through malice on the part of such companies. The Supreme Court of Missouri, in affirming the order of the lower court sustaining a demurrer to the plaintiff's complaint, expressly recognized the right of insurance companies to refuse to issue insurance, no matter what their real motive for so doing might be.[3]

So, also, it has been held that the proposal may be rejected even after the premium is paid.[4] But in general the contract cannot be rescinded by the insurer after the proposal is once accepted, without subjecting it to a just claim for damages for breach of contract; this on the plainest equitable principles. For inasmuch as the insured cannot, in the absence of special provisions in the contract itself, exercise the right of rescission after he has paid his premium and recover it back, it is only equitable to apply the same rule to the insurer.[5] So it has been held that where the insurer refuses to issue the insurance bond

[1] Ginsberg *v.* Union Sur. & Guar. Co., 68 N. Y. App. Div. 141; 74 N.Y. Sup. 561.

[2] 19 Mo. 583.

[3] See also Robinson *v.* Nat. Sur. Co., 31 Tex. Civ. App. 629; 73 S. W. 26.

[4] Otterbein *v.* Iowa St. Ins. Co., 57 Ia. 274; Weinhold *v.* Mutual Reserve F. L. Ass., 53 Fed. 208.

[5] People *ex rel.* Nat. Sur. Co. *v.* Feitner, 166 N. Y. 129; 59 N. E. 731.

after having once accepted a proposal for the same, the party injured by such a refusal may recover damages for whatever injury he may have directly suffered by reason of such refusal.[1] The measure of damages usually is the expense to which the party injured by the refusal is put in order to supply a new insurance bond.[2]

§ 24. **Legal Effect of Acceptance of Proposal and Application upon the Liability of the Insurer prior to the Issuance of the Policy.** — It is a very common practice on the part of guaranty insurance companies to issue what are known as "guaranty provisional receipts." The purpose of issuing these is to give the insured all the benefits of a valid policy without the possession of the instrument itself, while at the same time the insurer acquires thereby the same right to the premium as if the policy had been issued. The reasons for the giving of such provisional receipts are varied, sometimes arising from the necessity of sending to the home office of the insurer for the formal execution of the policy or again arising through the fact that the proposed policy is a "schedule" or "floating" policy, which is not to be formally delivered until the names of all contemplated "risks" are inserted therein. However that may be, the legal effect is the same whatever the reason for postponing the issuance of the policy. For the purpose of placing liability upon the insurer, the giving of the provisional receipts is equally as effective as if the policy itself had been once delivered. The only possible difficulty that can arise, so far as placing this liability upon the insurer is concerned, lies in showing just what the terms and scope of the policy applied for were to be. This can usually be done in one of two ways: either by a reference to a specimen policy, if any, exhibited at the time the insurance was solicited; or, in default of that, by reference to the fact that

[1] Samuels *v.* F. & C. Co. of N. Y., 1 N. Y. Sup. 850; 49 Hun, 122; 121 N. Y. 600; see same case reported in 27 N. Y. Sup. 741; 150 N. Y. 583.

[2] Am. Bond. & Tr. Co. *v.* Scott, 61 Pac. 873; see generally on this subject, McBride *v.* F. & C. Co. of N. Y., 37 S. W. 1091.

nearly all policies of this nature are uniform in style, their general provisions well understood, and being printed in advance, have certain well-known names applied to them, such as "bankers'," "agents'," "grain buyers'," etc., policies.

On the other hand, the legal effect of the acceptance by the insured of this provisional receipt is not necessarily the same as if the policy itself had been received by him. Thus, for instance, to make certain clauses of the policy binding upon him which are there inserted for the purpose of making the liability of the insurer contingent upon the observing of the conditions therein contained by the insured, it would have to be shown that these clauses and conditions were either brought to his attention, or were assented to by him before the policy was delivered, in order to enable the insurer to avoid liability on the ground that the insured had failed to observe the conditions therein contained.

Again, a letter of attorney to the general agent of a surety company empowering him to execute bonds guaranteeing the fidelity of persons holding places of public or private trust, and the "performance of contracts other than insurance policies," was held sufficient in law to authorize the execution of a bond guaranteeing the performance of a contract to repay money advanced to a building contractor.[1]

§ 25. **Parol Testimony is inadmissible to vary the Terms of Proposals or Applications.** — As preliminary to a discussion of this subject it may be observed that the proposal or application for a policy of guaranty insurance may either of them be made in writing, or orally, as the case may be. However, it is the almost universal custom on the part of guaranty insurance companies to require that both proposal and application be made in writing.

This being true, it is of importance to know whether such proposals or applications are subject to the general rule for-

[1] Pacific Nat. Bank *v.* Ætna Indemn. Co., 33 Wash. 428; 74 Pac. 590.

bidding the introduction of parol evidence to contradict, alter or vary the terms of valid written instruments. In general it may be said that in such cases it is incumbent upon the applicant, immediately upon the receipt of the policy, to notify the company of his refusal to accept the same. In the absence of proof to the contrary, it will be presumed that the applicant knew and indorsed the contents of the application when he signed it.

Oral statements are not admissible to alter the terms of written proposals or applications, these instruments being themselves the best evidence of their contents. Other writings may, however, become part of the proposal or application by being annexed thereto or subjoined, or by being referred to therein in plain terms as a part thereof, but the intent to incorporate other papers therein should be plainly manifest. All representations and agreements contained in applications and proposals are presumed to have been made by the parties signing the same, if no proof is given to the contrary. The signature annexed to such written application is presumed to have been made by the party signing the same, without proof as to his handwriting or his signature.[1] So, too, all prior negotiations, proposals and conversations are considered waived or merged in the written proposals or applications.[2] Where the proposals and applications are made in terms part of the policy itself, it should be remembered that no rule is better settled than that parol evidence is inadmissible to vary or contradict the plain and unambiguous terms of a written contract of insurance. Finally it may be said that the legal effect of a written instrument which defines and declares the intentions and rights of the parties cannot be modified or controlled by any preliminary negotiations or agreement, nor is it permissible to show how the parties undertook the transaction in order to explain or qualify what is in the final writing, in the absence of an alle-

[1] N. Y. Life Ins. Co. *v.* Fletcher, 117 U. S. 519.

[2] Knitting Mills *v.* Guar. Co., 137 N. C. 565; 50 S. E. 304.

gation of *fraud* or *misconduct*, or unless the terms of the instrument are ambiguous and require explanation.[1]

§ 26. **Nature and Form of the Insurance Policy requested as determined by the Application and Proposal therefor.** — This subject is one of practical importance in the domain of guaranty insurance. It is frequently the case that the "risk" never sees the policy which he requests, and derives whatever information he may have, as to the nature and provisions of the policy he seeks to secure, exclusively from the insured. This being so, the question arises at the very threshold, as to whether it is necessary, either to the validity of the policy or to the exercise of the right of indemnity by the insurer as against the "risk," that the latter should have seen the policy or known its provisions? The inquiry here suggested may be answered, generally speaking, in the negative. As between the insured and the insurer, the knowledge or lack of knowledge as to the contents of the policy on the part of the "risk" is wholly immaterial, unless by the terms of the policy itself the "risk's" general consent to the giving of this identical policy by the insurer, and his execution of an agreement to indemnify the insurer for any loss that the latter may sustain thereunder, is made a condition precedent to the validity of the policy. As between the insurer and the "risk," in the absence of fraud or concealment on the part of the former, it may require the "risk" to indemnify it from loss accruing under a policy given at the latter's request or by his consent, even where the "risk" has not seen the policy issued or known of the provisions it contained. The reason of this is obvious. Employment is given, as a general rule, on condition that a policy satisfactory to the employer (the insured) be furnished and liability of the "risk" to the insured to make indemnity follows as a matter of course upon the insured's acceptance of the policy submitted to it by the insurer. The latter is, for that purpose at least, deemed to be the agent of the "risk." When the policy is once accepted

[1] Knitting Mills *v.* Guar. Co., 137 N. C. 565; 50 S. E. 304.

by the insured, the "risk" is supposed in law to have read the same and to have assented to its terms. In the absence of fraud a person who is competent to contract is conclusively presumed to have made a contract which he signs though in fact ignorant of its contents.[1]

Turning now to the question as to the nature and form of the policy requested by the insured, it may be said that this is governed very largely by what is said in the proposal on the subject. It is rare, indeed, when a copy of the policy is annexed to such a proposal; so of necessity recourse must be had to extrinsic evidence to determine the nature and form of the policy desired. Such evidence does not conflict with the rule already given with reference to the inadmissibility of parol evidence to alter, contradict or vary the terms of written proposals.

The evidence here referred to simply serves to explain and render certain the terms of the proposed contract embodied in the proposal, and it is admitted in all cases as a matter of course, where the terms and form of the policy requested are referred to in the proposal in general terms only.

The main consideration is that the minds of the parties shall have met upon all the essential terms of the proposed policy. When this state of affairs exists, there can be no valid performance on its part when the insurer furnishes a policy that differs from that outlined in the insured's proposal, for the minds of the parties do not meet in such a case.

CHAPTER IV

THE POLICY, OR INSURANCE BOND

§ 27. **The Policy defined.** — The policy, or insurance bond, in all forms of guaranty insurance is the printed or written form to which the contract of the parties has been reduced

[1] See De Jernette *v.* F. & C. Co., 17 Ky. Law Rep. 1088; 33 S. W. 828.

and which evidences it. As has already been observed,[1] it is referred to in the courts by various names, the ones which commend themselves being that of "policy" and "insurance bond."[2]

§ 28. **Requisites of a Valid Fidelity Insurance Policy.** — The formal requisites of a valid guaranty insurance policy are eight in number and may be enumerated as follows: (1) Parties; (2) Premium; (3) Insurable interest in the insured; (4) Power, corporate and statutory, on the part of the insurer to issue the policy; (5) Statement of scope of liability growing out of acts of a designated "risk"; (6) Statement of duration of such liability; (7) Designation of the amount of liability assumed by the insurer under the policy; (8) Statement of the conditions under which the insurer will meet the liability specified in the policy.[3]

The foregoing statement in the text has been the subject of a broader interpretation by a court of last resort than was ever contemplated for it at the time it was written. Reference is here made to the decision of the Supreme Court of Washington in Pacific National Bank of Tacoma *v.* Ætna Indemnity Company.[4] The court in its opinion in that case spoke as follows:

"Appellant, however, cites 'Frost on the Law of Guaranty Insurance,' § 29, as supporting his contention that such a guaranteeing contract as the one before us is not binding unless the premium has been paid to the insurer. The author states that the existence of the premium as consideration distinguishes the contract of fidelity insurance from the obligation of private and gratuitous suretyship. He cites but one case in support of the paragraph cited,[5] but we are unable to see that the case is authority for the statement of the author. If

[1] *Ante,* § 7.

[2] City Tr. Safe Dep. & Sur. Co. *v.* F. & C. Co. of N. Y., 58 App. Div. 18; 68 N. Y. Sup. 601; Sloman *v.* Merc. Cr. Guar. Co., 70 N. W. 886; 112 Mich. 258.

[3] The first and fourth of the foregoing enumerated "requisites" have already been discussed at sufficient length. See *ante,* §§ 7–11. The remaining six will be treated in subsequent parts of this work.

[4] 33 Wash. 428; 74 Pac. 590.

[5] People *ex rel.* Nat. Sur. Co. *v.* Feitner, 166 N. Y. 129; 59 N. E. 731.

we understand it to be cited only on the point that the premium, in the absence of special provisions in the policy authorizing it, cannot be recovered back by the insured before offering to surrender up his policy, we are therefore left with the unsupported statement of the author. The broad doctrine announced, if legitimately applied, would seem to make it necessary in all cases for the person who is to be protected by a guaranteeing bond to see that the principal therein has paid the premium, and that, too, without regard to the fact that the bond has been actually delivered by the insurer. It seems to us the rule must be, when the insurer delivers a bond guaranteeing another, that the beneficiary may assume that the premium has been paid; otherwise that the bond would not have been executed and delivered. And that the insurer cannot afterwards be heard to say that the premium was not paid as against the beneficiary who has in good faith parted with value on the strength of the terms in the bond. Especially must this be so when there is no recital in the bond that the payment of the premium is a necessary prerequisite to the giving thereof."

The foregoing opinion — in so far as it states the law governing the particular question now before us — meets with the fullest approval of the writer. But the statement in the text was never intended to have the broad application claimed for it by the attorneys for the surety company in the case above referred to. It must be admitted without question that the payment of the premium may be of course waived by the insurer, and it may be further observed that the insurer may estop itself by its acts from claiming exemption from liability under a policy either on account of failure of the insured or the "risk" to pay the premium, or on account of the absence of any promise to pay a premium to the insurer running either from the insured to the "risk" or to a third party. The ordinary rules of law applicable to the subject-matter of consideration of contracts apply to guaranty insurance contracts the same as they do to ordinary commercial contracts. Thus, in line with the decision of the Washington Supreme Court in the case above cited, it may be said that where an insurer delivers a bond guaranteeing the acts of a designated "risk," the insured may assume that the premium

has been paid to the insurer and cannot afterwards be heard to say, as against the insured who has parted with value relying thereon, that the premium has not been paid. The original consideration that exists for the making of a contract which exists between the insured and the risk, the proper performance of which is guaranteed either in whole or in part by the issuance of a policy of guaranty insurance, is sufficient in itself to sustain such policy as against the surety company which issued it. That is, a consideration moving to the "risk" alone, cotemporaneous with or subsequent to the issuance of the policy by the surety company, is sufficient in law to sustain the binding obligation of such policy. Of course, in the absence of any of the elements of estoppel, such as would forbid the surety company insisting on the validity of conditions in a policy of guaranty insurance issued by it to the effect that the same would not be valid unless the premium thereon had been paid, such a condition would unquestionably be sustained by the court. Where a bond of indemnity does not stipulate how long it shall remain in force but covenants that so long as it shall so remain the surety company issuing it shall be paid an annual premium so as to continue the bond in force, but leaves the insured at liberty to decline to make payments, it may thus put an end to the contract in so far as the rights of third persons are not affected.[1]

§ 29. **The Premium.** — A contract of fidelity insurance, to be valid and binding, must be executed upon a valid consideration running from the insured to the insurer. This consideration is familiarly known as the premium. It constitutes the compensation which induces the insurer to assume a liability which may possibly amount to many times the amount of the premium received by it for writing the policy. The premium, in the absence of special provisions in the policy authorizing it, cannot be recovered back by the insured upon offering to surrender up his policy.

It is the existence of this premium as the consideration

[1] Fid. & Dep. Co. of Md. v. Libby, 72 Neb. 850; 101 N. W. 994.

for the execution of the policy which distinguishes the contract of fidelity insurance from the obligations of private and gratuitous suretyship.[1]

§ 30. **Insurable Interest in Fidelity Insurance.** — It being conceded that the policies issued by the "surety companies" are contracts of insurance, it would seem necessarily to follow that, in order to sustain the validity of such agreements, the insured should in all cases possess what is termed an "insurable interest" in such policies. Insurance of this character being preëminently a contract of indemnity, it is entirely logical to assert that this fact alone precludes the presence in all such contracts of the elements of speculation or profit.

The underlying reasons which render it necessary that the insured shall have an insurable interest in all fidelity insurance policies, where liability thereunder is sought to be enforced for his benefit, are mainly three in number:

First. It is contrary to the spirit of the law, which always favors legitimate business, that it should sanction speculation on the honesty or faithfulness of one's fellow-men.

Secondly. It is opposed to public policy in that it would permit a party to enter into a contract wherein it would be to his pecuniary interest to induce dishonesty or unfaithfulness on the part of the "risk," which would operate to his advantage and to another's pecuniary disadvantage. In other words, under such circumstances dishonesty and unfaithfulness would be at a premium, and honesty and faithfulness in public or private duty the last thing sought for.

Thirdly. In view of the fact that the policy is universally executed with reference to the independent contractual or official obligations of the "risk" to the insured, it is in harmony with the policy of the law, clearly recognized in the case of contracts identical in purpose with that entered into between the insured and the insurer in fidelity insurance, to insist that the right to enforce such contracts, as between the insured and the insurer, shall not be more extensive than the

[1] See *ante*, § 28.

right of the insured to enforce the contemporaneous contractual or official obligation of the "risk" to himself.[1]

With reference to the third of the foregoing enumerated reasons for requiring the possession of an insurable interest by the insured, the following may be said: The policy of fidelity insurance being essentially one of indemnity, to enforce a claim thereunder against the insurer for the benefit of an insured, who had no concurrent existing legal claim against the "risk" therefor, would be to change the nature of the agreement from one of indemnity to that of a wagering contract. To entitle the insured to recover under a fidelity insurance policy, it is in every instance incumbent upon him to show some invasion of his legal rights on the part of the "risk" which in itself constituted, at the time such recovery is sought, a valid enforceable claim against the "risk" in favor of the insured. On the general subject of insurable interest in guaranty insurance contracts, Mr. Cooley in his "Briefs on Insurance"[2] speaks as follows:

"The necessity of an interest in the subject-matter in property insurance is apparently based on the principle that a contract insuring property is strictly a contract of indemnity. On this principle we may regard as proper subjects of insurance any right of property the continued existence of which depends on the solvency of debtors, the fidelity of persons in places of trust, the performance of contracts, general compliance with the conditions of judicial bonds and the validity of title to real estate. It is obvious that an insurable interest is necessary to support contracts of guaranty insurance. The general principle emphasized in all cases, involving the extent of liability under guaranty and indemnity contracts, that the contracts are strictly contracts of indemnity, and that the measure of liability is the extent of actual loss, is strictly in accord with the principle that insurable interest is necessary, and it is consonant also with the general rule prevailing in fire and marine policies, that the extent of recovery is limited to the extent of interest. Since a guarantor cannot be held liable on his guaranty except to the extent that the original debtor or risk is

[1] See Independent School District, etc. *v.* Hubbard, *et al.*, 110 Ia. 58; 81 N. W. 241; Arents *v.* Commonwealth, 18 Grattan, Va. 750; see also Vol. I of Cooley's Briefs on Ins., pp. 236, 237.

[2] Page 236.

liable on his contract, it is evident that under a contract of guaranty insurance the extent of insurable interest is measured by the interest in the risk. On the other hand, recalling the legal definitions of insurable interest, it is a general rule that whatever furnishes a reasonable expectation of pecuniary benefit from its continued existence, or damages from its loss or destruction, is capable of supporting an insurable interest.[1] That is to say, an insurable interest exists whenever there is a reasonable degree of probability that the insured will suffer loss by reason of any contingency which affects the subject of the insurance.[2]

"That an employer may suffer loss from defalcation of a trusted employee is evident. The very purpose of the contract of fidelity insurance is to protect the employer from loss from this source, or, in the case of public officers, to protect the public. Consequently the employer in the one case, and the public in the other, has such an interest, based on the possibility of loss in the fidelity of the employee or officer, as to constitute an insurable interest within the definitions sufficient to support contracts of insurance indemnifying against such losses."

In every case, the relationship of the insured to the property injured by the wilful or negligent acts of the "risk" must be of such a nature as to result in pecuniary damage to the insured as a direct result of such acts. When this element exists, the necessary insurable interest is present to enable the insured to recover of the insurer under the policy.[3]

The general subject of insurable interest is discussed at length, though not under that name, in several recent cases, wherein recovery under policies of contract insurance was denied, on the ground that the claims upon which it was sought to found such liability did not constitute an enforceable liability in favor of the insured against the "risk." A careful reading of these cases seems to support the statement that the true test of the existence of an insurable interest lies in

[1] Nat. Marine Ins. Co. v. Winsmore, 124 Pa. 61; 16 Atl. 516.

[2] Agri. Ins. Co. v. Clancy, 9 Ill. App. 137.

[3] Claflin v. U. S. Cr. Sys. Co., 165 Mass. 501; 43 N. E. 293; Stillwell v. Com. Ins. Co., 2 Mo. App. 22; see also Electric Appliance Co. v. U. S. Fid. & Guar. Co., 110 Wis. 343; 85 N. W. 648; Am. Sur. Co. v. U. S. to the use of Barrett, 127 Ala. 349; 28 Sou. Rep. 664.

the contemporaneous existence of liability for the same claim on the part of the "risk" to the insured.[1]

Thus the necessity of the existence of an insurable interest in the insured as a condition precedent to any recovery on the bond as against the insurer was clearly and distinctly affirmed by the Circuit Court of Appeals for the Eighth Circuit in the case of Iowa Tillooet Gold Mining Co., Ltd., *v.* Bliss *et al.*[2] In this case the insured made both the insurer and the "risk" parties defendant in a suit brought on the bond to recover for an alleged shortage in the accounts of the "risk." The court in its opinion spoke as follows:

"The cause of action alleged in plaintiff's petition against the 'risk' is that while acting as secretary for the plaintiff he embezzled or unlawfully converted to his own use $12,000 of plaintiff's money; that against the guaranty company is that previous to such unlawful act it had given to plaintiff its bond in writing, wherein it agreed upon certain conditions to make good and reimburse to plaintiff all and any pecuniary loss of money, securities or other personal property, sustained by it by any act of fraud or dishonesty on the part of the 'risk' amounting to larceny or embezzlement. It is true that the 'risk' signed this bond, but he did not therein assume in any way any obligation to the plaintiff. His entire obligation or undertaking thereunder is with the guaranty company from and against all loss or damage of whatever nature it may sustain by reason of having given the bond to plaintiff. . . . The plaintiff does not, in this case, and in fact could not predicate a cause of action against the 'risk' upon this bond, but predicates the same wholly upon his wrongful act or tort; while that against the guaranty company is predicated alone upon its written contract, the liability of which is in no sense joint but several, and it rests upon distinct and separate grounds. *While the amount of the recovery, if it is liable, would be computed upon the same basis,* viz.: *the amount of the defalcation of the* 'risk,' that does not make either the liability or obligation of defendant joint."

The Supreme Court of North Carolina in a recent case stated the general principle governing contracts of compensated suretyship as follows: "Every contract of suretyship is based

[1] Electric Appliance Co. *v.* U. S. Fid. & Guar. Co., 110 Wis. 434; 85 N. W. 648; Am. Sur. Co. *v.* U. S. to the use of Barrett, Ala. ; 28 Sou. Rep. 664.

[2] 144 Fed. 446.

upon some contract made or obligation assumed by the principal obligor, and the *liability is measured by the obligation of the principal*."[1]

In the case of the German-American Title and Trust Company *v.* Citizens' Trust and Surety Company[2] it was suggested that a true test of the existence of an insurable interest is to see whether, in the exercise of the right of subrogation by the insurer against the "risk," the former would have a valid and enforceable claim against the latter. If not, it was suggested that the insurance must be void, as based upon an unenforceable contract; this on the principle that the insurance does not cover any obligation on the part of the insured, but an obligation of the "risk" only, as fixed by the latter's contract with the insured.

In another case the absence of any insurable interest in the insured named in the policy was in effect urged, though that term itself was not used as a defence to an action brought to recover thereunder.[3] In this particular instance the insurer had contracted to indemnify the insured against any loss arising from the fraud or dishonesty of the "risk," who was a factor at a certain town, in connection with his management of the insured's funds intrusted to him with which to buy cotton. The factor was one of a firm, and the contract for buying cotton for the insured was with the firm, and not with the "risk" individually, though a member of the firm. The policy recited that Gilliam, the "risk," had been appointed to the position of cotton buyer in the service of the insured, and further recited that the insured had delivered to the insurer a statement in writing relating to the duties and responsibilities of, and checks to be used upon, the "risk" in said position. It was contended that the fact that the contract was with the firm to which the "risk" belonged, and not with the "risk" individually, released the insurer from liability under its policy;

[1] Blades *v.* Dewey, *et al.*, 136 N. C. 176; 48 S. E. 26.

[2] 190 Pa. 247; 42 Atl. 682.

[3] Clifton Mfg. Co. *v.* U. S. Fid. & Guar. Co., 60 S. C. 128; 38 S. E. 790.

this apparently on the theory that the insurable interest of the insured consisted of the obligations to it of the firm as such rather than that of the obligations of its members as individuals. It appeared that the insurer, not only before but at the time it made the contract whereby it guaranteed the good faith of Gilliam (the "risk"), requested the insured to exhibit to it the contract had between Gilliam and it, and that the latter did exhibit the contract had between the insured and the copartnership of which the "risk" was a member. It was held that the insured could recover under the policy though its contract with the "risk" was in the name of the firm of which he was a member.[1]

The same doctrine is laid down by the Supreme Court of Louisiana in Mutual Building and Homestead Association *v.* Fidelity and Deposit Company of Maryland,[2] where it was held that a policy of commercial insurance was not affected with respect to the insurer's liability thereunder, by reason of the fact that the policy was originally issued upon two copartners as the "risk" therein named, and that after the insurance thereof one of the partners withdrew without the knowledge or consent of the insurer.[3]

Neither of the last two cases here referred to conflict with the rule requiring the insured to have an insurable interest in the policy, for in each case there existed a concurrent joint and several liability on the part of each member of the copartnership to meet all the lawful obligations thereof to the insured. This in itself furnished the insurable interest necessary to sustain the validity of the policy.

Not only must the insurable interest exist, but such interest must be neither illegal, immoral nor contrary to public policy. As a general principle fraud, illegality or even mistake, which may rescind the contract of the principal, induces the discharge of the sureties; but if the invalidity of the con-

[1] See also Bart *v.* McCutcheon & Co., 157 Fed. 182.

[2] 50 La. 291; 23 Sou. 405.

[3] See also Carstairs, *et al.* *v.* Am. Bond. & Tr. Co., 116 Fed. 449.

tract rests upon reasons personal to the principal in the nature of a privilege or protection, the principal acquires a personal defence against the contract, but the contract subsists and the sureties may be charged thereon.[1]

This principle is well illustrated by the case of McCanna and Fraser Company *v.* Citizens' Trust and Surety Company.[2] Here the insured, a foreign corporation, sought to enforce a fidelity insurance policy issued to it upon one of its agents employed by it in Pennsylvania, wherein a statute had been passed, requiring the procuring of a license to do business in such a state, in order to validate its contracts made therein. The agent named as the "risk" in the policy defaulted, and suit was brought in the Pennsylvania federal courts to enforce the insurer's liability under the policy. The right to enforce such a policy was denied on what was, in effect, the ground that the insured had no valid insurable interest in the policy. In its opinion in this case on appeal, the federal court of appeals said that the policy in suit must be regarded as taken to protect the insured while engaged in prosecuting its business in violation of law, and as such was clearly unenforceable and invalid.

§ 31. **Contents of Ordinary Fidelity Insurance Policies.** — The more important provisions common to policies of fidelity insurance may be enumerated as follows:

1. Name of the insured, commonly denominated as the employer.
2. Name of the "risk," commonly denominated as the employee.
3. Name of the insurer.
4. A reference to the application or proposal, or both, as the basis of the contract of insurance thereby entered into.
5. Recital of consideration.

[1] Smillie *v.* Head, 2 Rich. Law S. C. 590; Winn *v.* Sandford, 145 Mass. 302; Miller *v.* Gaskins, 1 Smeads & Marshalls Ch. Miss. 524; Daniel *v.* Barney, 22 Ind. 207; U. S. *v.* Am. Bond. & Tr. Co., 89 Fed. 925; 32 C. C. A. 420; but see *Contra*, City of Unionville *v.* Martin, 95 Mo. App. 28; 68 S. W. 605; City of St. L. *v.* Davidson, 102 Mo. 149; 14 S. W. 825.

[2] 74 Fed. 597; 76 Fed. 420; 24 C. C. A. 11.

6. Duration of time during which the liability of the insurer under the policy is to continue.

7. A provision making all declarations and statements of the insured as contained in the proposal with reference to the duties of the "risk," inspection of his accounts, etc., warranties.

8. Statement of the perils insured against.

9. Limitation as to the amount of liability under the policy.

10. Excepted perils for which the insurer assumes no liability.

11. Duty of furnishing notice of loss made imperative.

12. Duty of furnishing proof of loss made imperative.

13. Limitation of time within which notice of loss must be given in order to fasten liability, if any, upon the insurer.

14. Right to call for further proof of loss at the insurer's expense, and, if deemed necessary, to have the same verified by oath when demanded by the insurer.

15. Limitation of liability to losses occurring during the life of the policy.

16. Duty of the insured to notify the insurer of any circumstances tending to make the actual facts different from those represented in the proposal, or of any fact affecting the liability of the insurer at any time during the life of the policy.

17. Conditions rendering the policy void if the insured shall fail to notify the insurer of the occurrence of any act of dishonesty, unfaithfulness or negligence on the part of the "risk," which should have come to the notice or knowledge of the insured, or if the latter should continue to intrust money or valuable property to the "risk" after such discovery as has been referred to.

18. Clause making it a condition precedent to recovery on the part of the insured to assist, at the insurer's expense, in prosecuting any "risk," either criminally or civilly, on account of any claim placed with the insurer by the insured.

19. Reduction of liability *pro rata* in case the insured holds other insurance of a similar nature upon the "risk" for whose acts claim for reimbursement is made.

20. Arbitration clause, available upon the demand of either the insurer or the insured upon dispute arising with reference to the former's liability to the latter under the policy.

21. Right of cancellation reserved to the insurer on repayment of *pro rata* portion of premium.

22. Limitation of the right of suit under the policy by the insured against the insurer, to a certain designated time after the discovery of the loss.

23. Date, alteration clause, subscription and seal if necessary. To the above may be added many others, to which brief references will be made later on.

§ 32. **The Form of the Fidelity Insurance Policy.** — The form of the contract is a policy describing the subject-matter of the agreement, setting forth the consideration, and pledging the funds of the company to pay in case the event insured against happens, subject always, of course, to the conditions of the contract. It is in the special condition that the policy differs from an ordinary bond of indemnity with sureties, given by a clerk, servant or agent to secure his employers. These conditions refer, as in other kinds of insurance, to the various circumstances which attend the contract, such as the payment of premium, the truth of the statements in the proposal or application, the limitation of the perils assumed by the insurer, the notice of loss, mode of proof, times of payment, mode of adjustment, limitation of suit, etc., according to the special views and experiences of the insurers and with such modifications as the peculiarity of the liability assumed demands. To attain the desired end, the proposal contains such inquiries and answers as are calculated to enable the insurer to determine the moral value of the "risk." As in marine and fire insurance, the interest of the insured in the preservation of the property is secured by limiting the indemnification to a portion of the property lost, so in guaranty insurance the interest of the insured in preventing the occurrence of the event insured against is sometimes secured by providing that in case of loss only a percentage of the loss will be paid.[1] And a not unusual provision peculiar to this form of insurance is the requirement that in case of loss the insurer shall be entitled to the services of the insured, in whatever form they may be made available, in bringing the delinquent to justice.

A policy of guaranty insurance is the contract reduced to writing. Owing to the vast diversity in occupation of the various "risks" upon whom policies are issued, there can of

[1] Solvency Mut. Guar. Co. *v.* York, 3 H. & N. 588.

necessity be no "standard" policy, uniform in every state, such as is found in the case of fire insurance. It must in every instance be so framed as to meet the peculiar exigencies of the individual case. It is, however, of course, controlled by the duties which the "risk" will be called upon to perform, and the faithful performance of which is guaranteed by the insurer to the insured.

With respect to form, policies of fidelity insurance are of different kinds. They are sometimes known as "single," "schedule" and "floating" policies. A "single" policy covers acts and defaults of a single "risk," and is not open to substitution and change in the personality thereof. "Schedule" policies cover a large number of persons, all occupying relatively similar positions and sustaining essentially similar contract relationships to the insured. In such case but one policy is issued, and this covers all the "risks" enumerated upon the schedule annexed to the policy, and from which this form of policy takes its name. Substitution of one "risk" for another is not permitted in this class of policies except with the consent of the insurer.[1] "Floating" policies are frequently issued, and differ from schedule policies only in giving to the insured the right to change the personality of the "risk" under certain limitations. This right is usually secured by inserting in the policy some such provision as the following:

"That the insured shall have the right at any time during the currency of this policy to strike or deduct from said schedule the names of any of said employees or to make any changes or substitutions among them, or to add thereto the name of any new or other employee, or to increase or decrease the amount of security required, upon giving notice of such deduction, change, substitution, addition, increase or decrease to the company or its duly authorized agent in writing and receiving acknowledgment thereof; such notice to state the name, place of employment, date of employment, capacity in which employed and amount and security required as to each employee, and the insured shall not be liable for the acts of any employee after his name

[1] U. S. Zinc Co. *v.* Gen. Acci. Corp., Mo. ; 102 S. W. 605.

shall have been deducted from said schedule in accordance with such notice." [1]

§ 33. **The Execution of the Policy.** — It makes no difference in what form the insurer signs the policy, if it appears that the purpose was to bind itself. Where the name of a corporate insurer in a policy appears in full in the body thereof, and its seal is impressed opposite the attestation clause between the obligatory part and the condition and at the close of the whole instrument, the names of the president and secretary are signed, this being its customary method of executing sealed instruments, it is binding.[2] After the policy has been executed and delivered by the insurer to the insured, their right to contract further in regard to the insurance sought for by the one and furnished by the other is not lost. They have the same right to abrogate or modify the agreement they have made that they originally had to make it. This includes the right to modify the first agreement by mutual consent, and to substitute new terms for the original stipulation of the contract. When this has been done, the old terms cease to have effect, and the substituted stipulations take their place.[3]

Where the agent of defendant bonding corporation, who executed the bond on which plaintiff was bound, testified that he had no authority to execute the same on defendant's behalf, and would not have done so except under instructions from defendant's assistant secretary, plaintiff could not recover against defendant in an action for malicious prosecution based on such complaint, without proving that such action was within the authority of such assistant secretary.[4]

An instructive case in this immediate connection is that of

[1] See U. S. Fid. & Guar. Co. *v.* First Nat. Bank of Dundee, Ill. ; 84 N. E. 670.

[2] Union Guar. & Tr. Co. *v.* Robinson, 79 Fed. 420; 24 C. C. A. 650; Roberts *v.* Secur. Co., L. R. App. Cas. (1897), 1 Q. B. 111; F. & C. Co. of N. Y. *v.* Yoder, 63 Kan. 880; 64 Pac. 1027.

[3] Rice *v.* Fid. & Dep. Co., 103 Fed. 427; 43 C. C. A. 270.

[4] Beiswanger *v.* Am. Bond. & Tr. Co., 98 Md. 287; 57 Atl. 202.

the Pacific National Bank of Tacoma *v.* Ætna Indemnity Company.[1] In this case a letter of attorney was addressed by one of the officers of an indemnity company to a general agent, empowering the latter to execute a bond guaranteeing the fidelity of persons holding places of public or private trust. This agent was also authorized at the same time to guarantee the performance of contracts other than insurance policies. An indemnity bond was issued by the general agent, guaranteeing the performance of a contract by S. as trustee for another, and it stipulated that such a bond should not be valid until signed by the district agent. The evidence, however, showed that the general agent of the surety company had had the stipulations printed on the bond of his own motion, and that the requirement was not made by the surety company. The general agent personally induced the insured to incur obligations on behalf of S. as trustee, giving the bond as indemnity, and delivering it himself, having secured S.'s signature merely as a matter of form. It was held, first, that the letter of attorney to the general agent authorized the execution of a bond guaranteeing the performance of a contract to repay money advanced to a building contractor. Secondly, it was held that the bond became effective without S.'s written signature and was not invalid on the theory that the insured acted as agent for both the risk and the surety company. This too, even were S.'s signature necessary, as the general agent was acting within the scope of his authority and his consent to S.'s signature must be admitted to have been with the knowledge and consent of the surety company. The general agent having acted in the belief that by the issuing of the bond the surety company would be saved loss upon other bonds issued by the insurer, by means of advancements secured under the bond which he procured, the surety company was not in a position to assert that it did not consent to S.'s signature.

The foregoing decision, like many others in which the in-

[1] 33 Wash. 428; 74 Pac. 590.

surer has not been permitted to deny the execution of the policy, is based upon plain and well-recognized principles of equitable estoppel. This principle, briefly summarized, may be stated as follows: That where, by the pursuance of a certain line of conduct, on the part of the insurer and its agents, the insured has changed his legal position in reliance upon such line of conduct, then in such case the insurer will not be permitted to deny the natural results of the line of conduct theretofore pursued by its agents in the premises, to the material disadvantage of a third party. But where there is no opportunity for the application of the principle of estoppel here referred to, the insurer will be permitted to show the extent of its agent's authority in the premises and that such agent had no authority to execute the same.[1]

Again, an attempt to deny the execution of the policy will often be frustrated by the application of the equitable principle that where one of two innocent parties must suffer, that one must sustain the loss which reposed the confidence. Or, as it is sometimes expressed, where one of the innocent parties must lose, from the wrongful act or default of a third, that one must bear loss who negligently enabled the third party to cause it.[2]

§ 34. **What constitutes Acceptance of the Insurance Policy on the Part of the Insured?** — After the insurer has accepted the proposal for an insurance bond, there still remains the necessity of an acceptance, either expressed or implied, on the part of the insured before the contract becomes binding.

It is eminently improper and ineffectual for the insured, holding a policy subject to his approval and final acceptance, if satisfactory, to accept the same after loss has actually occurred.[3] Finally, it should be observed that there can be no legal delivery to the insured so long as there are unperformed conditions. In this connection it should be noted that policies

[1] See Beiswanger *v.* Am. Bond. & Tr. Co., 98 Md. 287; 57 Atl. 202.

[2] Am. Bond. & Tr. Co. *v.* Pub. Inc. Co., 150 Fed. 17.

[3] Bank of Asheville *v.* F. & C. Co. of N. Y., 89 Fed. 819; 32 C. C. A. 355.

of fidelity insurance frequently contain a provision that they shall not be valid and enforceable until the premium therefor is paid.

Such stipulations, in the absence of any ground of equitable estoppel, have not infrequently been held to be valid.[1] This being true, the question might easily arise whether payment of an unpaid premium by the insured to the insurer might legally be insisted upon after a loss had occurred under the policy. The conclusion would seem to be that there could be no recovery under such condition of affairs.[2]

Where a bonding company with knowledge of informality in the execution of a bond by its agent receives and retains the premiums paid for the bond, it is estopped in an action on the bond from urging such informality as a defence.[3]

§ 35. **Requisites of a Valid Fidelity Insurance Policy.** — A policy of guaranty insurance to be valid must not be against public policy, in violation of statute or contrary to good morals.[4] Fidelity insurance contracts not constituting commerce, as that word is used in the federal constitution, are subject to state control, whether the company issuing the policy be domestic or foreign.

In matters of form, statutory provisions merely directory, and not concerning either the essence of the contract, public policy or good morals, are not prohibitive of change in the subject-matter of the contract.

In regard to fidelity insurance contracts, the enforcement of which, it is claimed, would be contrary to public policy, it should be observed that the evil effect must be such as affects the public generally, and not such as affects some particular class in the community.

[1] See, however, Pac. Nl. Bank *v.* Ætna Indemn. Co., 33 Wash. 428; 74 Pac. 590; see also § 29, *ante*.

[2] See Bank of Asheville *v.* F. & C. Co. of N. Y., 89 Fed. 819; 32 C. C. A. 355.

[3] Farmers & Mer. Ins. Co. *v.* U. S. Fid. & Guar. Co., Neb. ; 108 N. W. 156; see also Am. Bond. Co. *v.* Burke, *et al.*, 36 Col. 49; 85 Pac. 692; Am. Bond. Co. *v.* N. A. C. Co., 125 Ill. App. 33.

[4] See *ante*, § 5.

So, again, where there are stipulations in the policy contrary to positive statute, it must be clearly shown that it was intended to violate the statute, and does in fact do so, to render the policy illegal.

The policy must contain the exact agreement of the parties in clear, intelligible and unambiguous terms. If there are any statutory requisites, they should be complied with if mandatory.

The essentials of a valid contract of guaranty insurance are the same as those considered necessary in the other branches of insurance law, and are commonly stated as parties, premium, a personality called the "risk," whose faithful conduct is the subject of the insurance, insurable interest, certain designated perils, duration, amount of liability and agreement to meet all specified liability within a designated time.[1]

On the general subject of validity of such contracts it may be said that, as they are proper subjects of private agreement, the parties thereto may bind themselves in any manner or to any extent not violative of public policy or positive statute.

This principle once established, it follows that whatever conditions are contained in policies coming within the foregoing rule will be upheld and enforced by the courts.[2] A contract, therefore, may be void because it violates statutory law, or for the same reasons the stipulations of the contract may be enforceable. So the contract may be illegal because contrary to positive law, or an agreement may be void both on the ground of public policy and because contrary to the statute.

In considering, however, the validity or invalidity of policies of fidelity insurance, there is a difference to be observed between those cases where the invalidity of the contract rests upon some law which relates to the contract itself, and the rights and obligations to be performed thereunder, and those

[1] See *ante*, § 28.

[2] Molson's Bank *v.* Guar. Co. of N. A., Montreal Law Rep., 4 Sup. Ct. Rep. 376; 82 Am. Cas. 760–764.

cases where the invalidity or illegality rests upon some law which does not define or attempt to define the rights and duties of the parties. There is also a distinction between an agreement to do a thing which cannot be performed without violating the law, and an agreement to perform in an illegal manner a contract which can be legally performed. In the latter case an intention to break the law must be shown.

There are, too, certain general principles governing these contracts of fidelity insurance and liability thereunder which should be here stated. Thus any liability may be insured against wherein the insured has an insurable interest, except such as are repugnant to public policy, positive prohibition, or are occasioned by the insurer's own fraud or misconduct, and within these limits the parties may, as a rule, make such contracts as they choose, and may qualify or limit the liability assumed with or by specification of the amount of indemnity, or by the enumeration of certain perils or by the exclusion of certain specified perils. It may be stated as a general rule that the loss must be occasioned by one of the perils specified in the policy and not excepted, to entitle the insured to recover.[1]

§ 36. **Interpretation of Policies.** — When the subject of the interpretation of fidelity insurance policies is under discussion, that term is to be understood as referring to the question of the meaning of the words therein used.

Here the general rules applicable to other contracts clearly govern; that is to say, that words are to be taken to have their popular and natural meaning and are not to be taken in their restricted sense, unless it is clearly apparent that they were used in a technical sense by the parties.

So with reference to both interpretation and construction, fidelity insurance contracts are to be construed, as far as the capacity of the parties to make them are concerned, by the law of the place of contract.

But when a policy is executed in one state, with a view to

[1] Industrial & Gen. Tr. Co. *v.* Law. Sur. Co., *et al.*, 67 N. Y. Sup. 362.

its performance in another, the law of the latter state furnishes the rule for determining its obligation.[1]

§ 37. **Construction of Policies.** — Construction in its full legal import seeks to apply such meaning to words as is called for by the surrounding circumstances and the intent of the parties. Thus, words must be interpreted by their context, so as to produce a rational result. Inasmuch as it is in matters of construction that the rules of guaranty insurance may be so clearly differentiated from those applicable to gratuitous suretyship, this general subject deserves and will receive extended attention.

The question now before us first received general attention from the Supreme Court of the United States a number of years ago in the case of American Surety Company *v.* Pauly.[2] In this case the court spoke as follows:

"If, looking at all its provisions, the bond is fairly and reasonably susceptible of two constructions, one favorable to the bank and the other favorable to the surety company, the former, if consistent with the objects for which the bond was given, must be adopted, and this for the reason that the instrument which the court is invited to interpret was drawn by the attorneys, officers and agents of the surety company. This is a well-established rule in the law of insurance. As said by Lord St. Leonards, in Anderson *v.* Fitzgerald,[3] 'it (a life policy) is, of course, prepared by the company, and if therefore there should be any ambiguity in it, must be taken, according to law, most strongly against the person who prepared it.' There is no sound reason why this rule should not be applied in the present case. The object of the bond in suit was to indemnify or insure the bank against loss arising from any act of fraud or dishonesty on the part of O'Brien in connection with his duties as cashier, or with the duties to which in the employer's service he might be subsequently appointed. That object should not be defeated by any narrow interpretation of its provisions, nor by adopting a construction favorable to the company, if there be another construction equally admissible under the terms of the instrument executed for the protection of the bank."

[1] Am. Cr. Ins. Co. *v.* Car. Fur. Mfg. Co., 95 Fed. 111; 36 C. C. A. 671; Goodman *v.* Merc. Cr. Guar. Co., 45 N. Y. Sup. 511; 17 N. Y. App. Div. 474; see also Knitting Mills *v.* Guar. Co., 137 N. C. 565; 50 S. E. 304.

[2] 170 U.S. 133.

[3] 4 H. L. Cas. 484, 507.

Later, in the case of Guaranty Company of North America *v.* Mechanics Saving Bank and Trust Company[1] the court quoted with approval the foregoing excerpt from the opinion in the Pauly case cited above, and added the following:

"But this rule cannot be availed of to refine away terms of a contract expressed with sufficient clearness to convey the plain meaning of the parties and embodying requirements, the compliance with which is made the condition to liability thereon."

Again, in the United States Fidelity and Guaranty Company *v.* United States[2] the court spoke as follows:

"The question involved is whether the ordinary rule that the guarantor in case the time fixed for the performance of the contract by the principal be extended, applies to a bond of this kind executed by a guaranty company, not only for the faithful performance of the original contract, but for the payment of the debts of the principal obligor to third parties. It is conceded that by the general law of suretyship any change whatever in the contract for the performance of which the guarantor is liable, made with his consent, such, for instance, as the extension of time for the payment, if made upon sufficient consideration, discharges the guarantor from liability. Counsel for the insured argued with much persuasiveness that this rule of *strictissimi juris*, though universally accepted as applicable to the undertaking of an ordinary guarantor, who is usually moved to lend his signature from motives of friendship or expectations of reciprocity and without pecuniary consideration, has no application to the guaranty companies recently created, which undertake, upon the payment of a stipulated compensation, as a strictly business enterprise, to indemnify the insured, the obligee in the bond, against any failure of the obligor to perform his contract. It is at least open to doubt, however, that any relaxation of the rule should be permitted as between the obligee and the guarantor which may have signed the guarantee in reliance upon the rule of *strictissimi juris* and with the understanding that he is entitled to the ordinary protection accruing to guarantors against changes in the contract or extensions of the time of payment. The government wisely protects itself in these cases by providing in the bond that the obligation of the surety shall extend to all changes in the conditions of the contract which may be thereafter made and ones

[1] 183 U. S. 402; 46 L. E. 253. [2] 191 U. S. 416; 48 L. E. 242.

which we have held extend to such changes as might be found advantageous or necessary in the plans and specifications, but does not extend to a change in the erection of the structure to be built." . . .

"The rule of *strictissimi juris* is a stringent one, and is liable at times to work a practical injustice. It is one which ought not to be extended to contracts not within the reason of the rule, particularly when the bond is underwritten by a corporation which has undertaken for a profit to insure the obligee against a failure of performance of the part of the principal obligor. *Such a contract should be interpreted liberally in favor of the subcontractor, with a view to furthering the beneficent object of the statute.* Of course, this rule would not extend to cases of fraud or unfair dealing on the part of a subcontractor, as was the case in the United States use of Heise *v.* American Bonding and Trust Company[1] or to cases not otherwise within the scope of the undertaking."

In the opinion of the writer the Supreme Court of Washington has stated the true rule governing the general subject of construction in contracts of guaranty insurance. The leading case on this point is Cowles *v.* United States Fidelity and Guaranty Company, *et al.*,[2] where, speaking on this general subject, the court observed:

"It is contended by the appellant that a distinction exists between the liability of a non-compensated surety and that of a compensated surety; that the doctrine of *strictissimi juris* which has been invoked successfully by the accommodation bondsmen should not apply to parties who furnish bonds for compensation. We have not been able to obtain any light from the cases cited from this court any further than that they discountenance the old rule that there should be a distinction in consideration between bonds and other contracts, even in cases where the bonds were given purely as a matter of accommodation. We think, however, on general authority that while this class of suretyships is comparatively new, a distinction has been clearly countenanced by the courts, and that this character of suretyship is governed by the rules governing insurance contracts. Guaranty insurance is thus defined by Mr. Frost in his work on the 'Law of Guaranty Insurance,' § 2, as follows: 'For purposes of classification and treatment herein guaranty insurance contracts may be divided into three general classes — those of fidelity and commercial and judicial

[1] 89 Fed. 921, 925.

[2] 32 Wash. 120; 72 Pac. 1032.

insurance.' Commercial insurance is defined as having reference to indemnity agreements issued in the form of insurance contracts or policies; whereby the parties to commercial contracts are to a definite extent guaranteed against loss by reason of a breach of contractual obligations on the part of the other contracting party. To this class belong policies of contract, credit and title insurance. Then follows a definition of fidelity insurance and judicial insurance, distinguishing them from commercial insurance. In his criticism of courts which have insisted on following the old rule, the author pertinently remarks: 'It is but natural that courts so long accustomed to extending the rule of favoritism towards the surety in the old-time private bonds should be slow to recognize that, with the passing away of the reason for the existence of the rule by the advent of compensated surety, the rule itself should pass away. The contract of guaranty insurance is uniformly entered into for a compensation usually after the fullest investigation and frequently under stipulations largely technical in character and based upon written representations relative to the nature and extent of the risk. The policy is written by a company incorporated for the purpose of furnishing guaranty bonds as a means of revenue to the corporation and its stockholders.' This class of insurance can be distinguished in principle from what is called 'guaranty insurance,' whereby the guarantee company guarantees the honesty of employees.

". . . The bond is subject to the contract so made. It is the contract instead of a bond which is primarily to be construed, and the construction of the contract cannot be affected by the fact that a bond is given for its performance. It must be construed with reference to the intention of the parties to the contract, and whatever is binding upon them is binding upon the surety who becomes a party to the contract identified with the contractor."

Again, in Remington *v.* Fidelity and Deposit Company of Maryland [1] it was said that bonds of this character are in their nature insurance contracts to indemnify the employer against the dishonesty of employees. They are issued for profit, and the same rules of construction must be applied thereto as apply to other insurance contracts. If, looking at all its provisions, the contract is fairly and reasonably susceptible of two constructions, one favorable to the insurance company and the other unfavorable, the latter, if consistent with the object for which the contract was made, must be adopted,

[1] 27 Wash. 429; 67 Pac. 989.

for the reason that the instrument which the court is required to interpret was prepared by the officers and agents of the insurance company.[1]

"It is well settled," remarks the Supreme Court of Arkansas in its opinion in the case of American Bonding Company *v.* Morrow,[2] "that the bond of a surety company, like any other insurance policy, is to be most strictly construed against the insurer. The language of the bond is that selected and employed by the insurer and the instrument must be given the strongest interpretation against the insurer which it will reasonably bear."[3]

So again the United States Circuit Court of Appeals (sixth circuit) in the case of Guaranty Company of North America *v.* Mechanics Savings Bank and Trust Company[4] in reference to the same subject spoke as follows:

> "Nothing is to be implied, not necessarily indicated by words used as might be in other examples of insurance where the relation of the parties and the character of the risk are different, and where these relations properly breed implications that would import a meaning not admissible when the thing guaranteed is so far disassociated from any duty owing by the assured to the insurer as we find in the subject-matter of insurance here.
>
> "Where two provisions of a policy are susceptible of a construction which will give a fair and reasonable effect to both, this construction should be adopted. Such provision ought to be so construed as not to make the one destroy the other, nor so as to give a significance to the contract never intended by the parties, and thereby to overthrow the elementary rule governing all judicial proceedings, that is, that upon the one who makes a claim there rests the burden of establishing it."[5]

[1] To the same effect see Pacific Nat. Bank of Tacoma *v.* Ætna Indemn. Co., 33 Wash. 428; 74 Pac. 590.

[2] 80 Ark. 49; 96 S. W. 613.

[3] To the same effect as above see the following cases: Am. Bond. & Tr. Co. of Baltimore *v.* Burke, 36 Col. 49; 85 Pac. 692; Champion Ice & Cold Storage Co. *v.* Am. Bond. & Tr. Co., 115 Ky. 863; 75 S. W. 197; Granite Bldg. Co. *v.* Sayville Adminis., 101 Va. 217; 43 S. E. 351.

[4] 80 Fed. Rep. 766; 26 C. C. A. 146; reversed in 183 U. S. 402; 46 L. E. 253, on other grounds.

[5] See dissenting opinion of Justice White, Am. Sur. Co. *v.* Pauly, 170 U. S. 180.

In Supreme Council Catholic Knights of America *v.* Fidelity and Casualty Company [1] it was said that, "with reference to bonds of this kind executed upon a consideration by a corporation organized to make such bonds for profit, the rule of construction applied to ordinary sureties is not applicable. The bond is in the terms prescribed by the surety, and any doubtful language should be construed most strongly against the surety and in favor of the indemnity which the assured had reasonable grounds to expect. The rule applicable to fire and life insurance is the rule by analogy most applicable to a contract like that in this case." Again, in Lombard Investment Company *v.* American Surety Company,[2] it was held that "if the whole policy be susceptible of two constructions, one fixing the liability of the insurer and the other exempting him from liability, that construction is to be preferred which fixes the liability on the underwriters. But while this is correct, another well-recognized canon of construction is that ordinary words and terms shall be given their ordinary accepted meaning, and that the real intent and meaning of the parties to the contract is to be sought out through the instrument as a whole, so that due effect and operation shall be given to all its parts and provisions, so as, if possible, to make them all harmonious and consistent."

The rule thus given is undoubtedly sound and salutary in its effect. It may be safely asserted that most of the rules applicable to the construction of ordinary insurance policies are equally applicable to contracts of fidelity insurance.[3]

The Illinois Supreme Court in a very recent case [4] in construing a fidelity insurance policy held specifically that the same was in legal effect a contract of insurance and so subject to the rules of construction applicable to insurance policies

[1] 63 Fed. 48; 11 C. C. A. 96.

[2] 65 Fed. 476.

[3] Mech. Sav. Bank *v.* Guar. Co., 68 Fed. 459; Sup. Coun. Cath. K. of A. *v.* F. & C. Co. of N. Y., 63 Fed. 48; 11 C. C. A. 96; Cotten *v.* F. & C. Co. of N. Y., 41 Fed. 506; Am. Bond. Co. *v.* Morrow, Ark. 96 S. W. 613.

[4] U. S. Fid. & Guar. Co. *v.* First Nat. Bank of Dundee, Ill. ; 84 N. E. 670.

generally. "Contracts of guaranty insurance," observed that court, "are made for the purpose of indemnity to the insured, and they should be liberally construed to accomplish the purpose for which they were made."

In this connection it may serve some useful purpose to reproduce here certain of the more important rules of construction applicable to fidelity insurance policies.[1]

First. "As between the insurer and the insured, if the words of the policy are of doubtful import, that construction shall be placed upon them which is most favorable to the holder," with a due regard to the design and object of the policy as a contract of indemnity.[2]

The doctrine of the law is that a party who makes an instrument, being charged with the duty of making all conditions certain and clear, should take care to so express himself as to the extent of his liability that he may not be held further than it was his intention to be; and that the party who receives the instrument should always have a construction put upon it in his favor, because the words of the instrument are not his, but those of the other party.[3]

Second. Where the language defining the scope of the insurer's liability is unambiguous and clear, then the words thus used should be given their ordinary and natural meaning, so as not to extend such liability by process of construction.[4]

Third. In matters of construction the whole contract should be considered in order to determine its legal effect. This is peculiarly applicable to cases where the attempt is made to restrain the conditions of the policy by the recitals therein contained.[5]

[1] Union Sewer Pipe Co. *v.* Olsen, *et al.*, 84 N. W. 756.

[2] Field *v.* Cit. Ins. Co., 11 Mo. 51.

[3] Jaeckel *v.* Am. Cr. Ins. Co. of N. Y., 54 N. Y. Sup. 505; Am. Bond. Co. *v.* Morrow, 80 Ark. 49; 96 S. W. 613.

[4] People *v.* Mer. Cr. Co., 55 App. Div. N. Y. 594; 67 N. Y. Sup. 447; Am. Bond. Co. *v.* Pub. Inc. Co., 150 Fed. 17.

[5] U. S. Fid. & Guar. Co. *v.* Board of Commissioners, 145 Fed. 544.

Fourth. In ascertaining the intention of the parties, reference should always be had to the perils against which the policy was issued as well as to the situation of the parties.[1]

Fifth. All defeasance clauses must be strictly construed against the insurer.[2]

Sixth. All parts of the contract should be effected rather than defeated if this can be done without defeating the plain intention and purpose of the parties.[3]

Seventh. Where the policy refers to other instruments for the purpose of reference or in order to incorporate the provisions of the same therein, all must be read, construed and enforced together; for in such case the real contract of the parties consists of all the stipulations and provisions contained not only in the policy itself, but of those in said instruments as well.[4]

Eighth. A construction, in case of doubt, must, as a last resort, be adopted, which is sanctioned by the general principles and nature of insurance law.[5]

Ninth. Where one provision of a policy is in harmony with a statute under which it is given, and the other not, force and effect should be given to the first provision.[6]

Tenth. The general purpose of all forms of guaranty insurance is indemnity pure and simple, and the contract, if such purpose is to be effected, must at all times be so construed as to advance this principle.[7]

Eleventh. If an instrument is susceptible of two construc-

[1] Field *v.* Cit. Ins. Co., 11 Mo. 51; Am. Bond. Co. *v.* Pub. Inc. Co., 150 Fed. 17.

[2] Am. Cr. Ins. Co. *v.* Cassard, 83 Md. 272; 34 Atl. 703.

[3] Am. Cr. Ins. Co. *v.* Cassard, 83 Md. 272; 34 Atl. 703; Am. Sur. Co. *v.* Thurber, 21 N. Y. St. Rep. 459; T. M. Sinclair Co. *v.* Nat. Sur. Co., 132 Ia. 549; 107 N. W. 184.

[4] Rice *v.* Fid. & Dep. Co., 103 Fed. 427; Wood Sewing Mach. Co. *v.* Witchell, *et al.*, 107 Ind. 260.

[5] Talcott *v.* Nat. Cr. Ins. Co., 51 N. Y. Sup. 84.

[6] Walker *v.* Holtzclaw, 57 S. Car. 459; 35 S. E. 754.

[7] Clark *v.* U. F. & M. Ins. Co., 7 Mass. 365.

tions, one legal and the other illegal, the presumption is always in favor of the legality of the instrument.[1]

Twelfth. If a policy is so drawn as to leave room for two constructions of its provisions, either of which, it may be conceded, is reasonable, one favorable to the insurer and the other favorable to the insured, and most likely to subserve the purposes for which the policy was written, then it is to be construed most strongly against the insurer as the party who prepared the policy and delivered it to the one for whose protection it was executed.[2]

Thirteenth. Where a contract is susceptible of two constructions, one of which will accomplish the intention of the parties to make the contract an enforceable one, while the other would make it unenforceable and meaningless, the former is to be preferred. Ambiguity in a certain provision of a contract is to be taken most strongly against the party who chose the language in which this provision is expressed, but this rule is to be resorted to only when all others fail.

" One of the canons of construction is to give effect to every provision of a contract if possible and practicable, for the reason that the parties themselves evidently intended something thereby, and it is not for the courts to reject the same unless it be so formed that only a formal intent can be gathered therefrom. In other words a contract should be so construed, if possible, as to give effect to each and every provision thereof.

And manifestly this must be so, for it presupposes a binding contract of some kind and is particularly a rule of construction and not of destruction. To arrive at the intent of the parties the surrounding circumstances should be taken into account

[1] Glover *v.* Am. Cas. Ins. & Secur. Co., 130 Mo. 173; 32 S. W. 302; T. M. Sinclair Co. *v.* Nat. Sur. Co., 132 Ia. 549; 107 N. W. 184; Am. Bond. & Tr. Co. *v.* Pub. Inc. Co., 150 Fed. 17.

[2] Am. Sur. Co. *v.* Pauly, 170 U. S. 160. See generally on the question of construction of guaranty insurance contracts: Penn. Mut. Life Ins. Co. *v.* Mech. Bank & Tr. Co., 72 Fed. 413; Am. Cr. Indemn. Co. *v.* Car. Fur. Mfg. Co., 95 Fed. 111; 36 C. C. A. 671; Am. Bond. Co. *v.* Morrow, 80 Ark. 49; 96 S. W. 613.

and the court should place itself as nearly as may be in the position of the parties who make the contract. It should look to the subject-matter of the contract, the relation of the parties thereto and the objects and ends intended to be accomplished thereby. In so doing it should take into consideration other contracts having reference to or bearing upon the one before it, especially where the latter has reference to the same subject-matter as the former, and is the means whereby the former is carried out.[1]

The matter of the proper construction of policies of fidelity insurance is one of such great importance that it seems advisable to summarize briefly the position of the courts generally on this subject. It can be stated without fear of contradiction that in fidelity insurance there is no longer any attempt to invoke the rule in favor of the compensated surety that sureties are favorites of the law, and as such should be favored in all matters of construction. It may be stated unequivocally that in this branch of insurance at least the *strictissimi juris* rule has no application whatsoever. Contracts of fidelity insurance must be construed like any other class of insurance contracts liberally, and in all cases all ambiguity arising therefrom must be solved in favor of the insured and against the insurer which drafted the instrument.[2]

[1] T. M. Sinclair & Co., Ltd. *v.* Nat. Sur. Co., 132 Ia. 549; 107 N. W. 184.

[2] See Am. Bond. & Tr. Co. *v.* N. A. C. Co., 125 Ill. App. 33; Am. Bond. & Tr. Co. *v.* Morrow, 80 Ark. 49; 96 S. W. 613; Am. Bond. Co. *v.* Burke, 36 Col. 49; 85 Pac. 692; Am. Sur. Co. *v.* S. G. L. & Tr. Co., Tex. ; 98 S. W. 387; T. M. Sinclair & Co., Ltd. *v.* Nat. Sur. Co., 132 Ia. 549; 107 N. W. 184.

CHAPTER V

ATTACHMENT AND DURATION OF LIABILITY IN FIDELITY INSURANCE COVERING PERSONS OCCUPYING POSITIONS OF PRIVATE TRUST

§ 38. **Attachment of Liability under Policies covering Persons holding Positions of Private Trust.** — Perils of a kind calculated to give rise to a legal liability on the part of the "risk" to make good to his employer (the insured) all damage arising through wrongful acts on his part, are of the essence of fidelity insurance, and form the principal foundation of the contract. When the agreement between the parties is consummated, the insurer takes upon itself the responsibility for the perils which the property or interests of the insured are liable to encounter. By necessary implication the contract involves the presumption that such property or interests of the insured will be exposed to perils of some sort. The important question then arises: At what times does the liability of the insurer under such a contract arise, and for how long a period does it continue? Inasmuch as the foundation of guaranty insurance rests upon the principle of non-liability for any loss not occurring within the life of the policy, it would seem to necessarily follow that liability should not attach until the time named in the policy for such attachment arrives. Thus it may be said that any provision in the policy with reference to the period for which it is to run is conclusive upon the parties therein named. The contract of insurance is deemed to be operative only during the period prescribed in the policy itself, and is deemed to take effect at the time mentioned therein, if delivered to the insured. The policy, however, is not invalid because it has no written date.

In one case, where the policy given for the fidelity of an employee recited that it was for a term of one year from July 1, 1891, to July 1, 1892, and there was indorsed on the back of

the policy words to the same effect, but the policy was dated July 10, it was held that it was properly construed as taking effect from July 1, 1891, without regard to the evidence as to when it was accepted.[1]

Again, in Ætna Insurance Company *v.* American Surety Company[2] a policy issued upon the agent of an insurance company bore date June 15, 1884, and it was not delivered nor accepted by the insured until July 29, and the certificate as to the character of the agent, which had previously been submitted to the insured, contained a blank to be filled in by him, stating when the bond was to be dated, and in this blank had been written "June 15 or June 16, 1884," the policy itself declaring that it was made June 15, 1884, and that it was in consideration of the premium for a term of twelve months ending June 15, 1885. The court held that the liability of the insurer under the policy accrued by relation as of the time of its date. A most instructive case with respect to the question of attachment of liability is that of Hall *v.* United States Fidelity and Guaranty Company.[3] The facts therein stated are as follows: The United States Fidelity and Guaranty Company was an insurance company engaged in guaranteeing the fidelity and honesty of persons in the employ of others. On March 9, 1898, one Newton, a stranger to Hall, the insured, applied to him for employment as his agent for the purchase of potatoes on commission at River Falls, Wisconsin. The guaranty company had been in the habit of insuring the fidelity of the insured's employees, and sent its agent with Newton to Hall's office in Minneapolis to procure employment for him. The agent of the guaranty company then made a written application for insurance, and informed the company that Newton was an entire stranger to him and to Hall, and that the insurance was wanted without delay. The next day the insurance company delivered to Hall the following contract:

[1] Sup. Coun. *v.* F. & C. Co., 63 Fed. 48; 11 C. C. A. 96.

[2] 34 Fed. 291.

[3] 77 Minn. 24; 79 N. W. 590.

"In consideration of the sum of $5 the United States Fidelity and Guaranty Company hereby guarantees the fidelity of A. Tracey Newton in the sum of $500 in favor of C. H. Hall and Company, from the ninth day of March, 1898, to the ninth day of March, 1899, subject to all the covenants and conditions set forth and expressed in the bond of this company to be issued of even date herewith and forwarded from the home office within fifteen days from the date of issue. All liability of the company on this instrument shall cease and determine on the issuance by the company of a duly executed bond, or, if the bond is not issued on the fifteenth day, from the countersigning of the said instrument by the general agent."

Across the face of this instrument was written in ink "Subject to the result of investigation." Upon receipt of this contract the insured employed Newton and advanced him money to purchase potatoes for it at River Falls, Wisconsin. Later, upon default of the "risk," the insured brought an action on the contract upon the claim that the "risk" had embezzled $211.53 of his money within the fifteen days mentioned in the contract. On the trial, the insured had a verdict for that amount, and the guaranty company appealed. The Supreme Court of Minnesota, in its opinion in this case, observed that "appellants' contention that the words 'subject to the result of investigation,' written across the face of the contract, converted what otherwise would have been a contract into a mere proposal for one, to become binding on defendant only in the case that the investigation proved satisfactory, was untenable. . . . This construction," the court said, "would render the temporary contract wholly meaningless and nugatory. The insured had already made application for insurance, and there was no occasion for a counter-proposal. The contract states in plain and decided terms that the insurer hereby guarantees the fidelity of Newton, and that all liability on the instrument shall cease on the issuance of the regular bond, or in fifteen days, if no such bond is issued. Why should such language be used, if it was not intended to mean anything? If a mere proposal was intended, why not rest upon the insured's written application and wait for the bond? In our

opinion, the words "subject to the result of investigation" should be so construed as to merely give to defendant a right of cancelling the contract on further investigation and thereby exempt itself from any loss resulting from continuing Newton in the employ of the insured after notice of the cancellation. This construction will give effect to all parts of the contract, and it seems to us in accord with the intention of the parties."[1]

In general a bond speaks from its date, but upon proof that it was delivered at a later time the primary presumption is displaced by one that it was intended to take effect from its delivery only, unless by its terms it specifically appears that the parties intended it to take effect from its date or some other time.[2]

§ 39. **Duration of Liability under Fidelity Insurance Policies covering "Risks" holding Positions of Private Trust.** — In the days of private suretyship the question of the time during which the liability of the bondsmen continued to exist was an important as well as at times a most difficult one to determine. With the advent of guaranty insurance companies most of the difficulties that once surrounded this subject have disappeared. The policies issued by these companies generally prescribe in definite terms the period for which they are to run. If not, the extent of liability in point of time is so clearly suggested as to render the matter ordinarily one of little difficulty. Under the old surety bonds procured for private individuals and public officials, a great many questions arose with reference to the period of time covered by the bond procured in connection with the performance of public or private duty by such persons. These questions, as has already been suggested, are now very largely things of the past. In private suretyship, where no definite period of liability was named in such bonds, the sureties thereon were usually held to be

[1] As to what time the liability attaches, see Shakman *v.* U. S. Cr. Sys. Co., 92 Wis. 366; 66 N. W. 528; see also Am. Bond. & Tr. Co. *v.* N. A. C. Co., 125 Ill. App. 33.

[2] Brillon Lumber Co. *v.* Barnard, 131 Wis. 284; 111 N. W. 483.

liable only for one year, because such is presumed to have been the intention of the parties. But there is nothing to prevent such sureties from becoming bound for a longer time, and if an intention to that effect clearly appears, they will be so held.[1]

Thus in a recent North Carolina case[2] the directors of a bank, at a meeting held in March, 1891, elected the "risk" named in a fidelity bond as its cashier for one year and fixed such bond at $20,000. At a subsequent meeting of the Board, the bond was accepted, reciting as follows: "Whereas, the above bonded D. has been chosen and appointed cashier, etc." The condition of the bond was worded to the effect that if the "risk" should well and truly serve the bank and properly discharge all his duties as such cashier, and should render a true account of all monies, that thereupon the bond should become null and void. At the expiration of the term D. was reëlected cashier "for the ensuing year," and his bond fixed at the same amount as during the prior year, and he was thereafter reëlected from year to year, without any new bond being given until his default in 1903. The court held that under the recital in the bond whereby there was recited in terms the cashier's appointment for one year, that this controlled and restricted the conditions of the bond, and that the surety thereon was not liable for defalcations committed after the expiration of the first term.

Again, in another case,[3] a bond unlimited by its terms as to duration was given for the faithful performance of duty by an officer of a corporation. In it the term of office was one to be prescribed. It was held that such bond will, in the absence of a showing to the contrary, be construed to cover only such prescribed term. In this case the bond was given by the defendant surety company for the faithful performance of the

[1] See F. & C. Co. of N. Y. *v.* Lawler, *et al.*, 64 Minn. 144; 66 N. W. 143.

[2] Blades *v.* Dewey, *et al.*, 136 N. C. 176; 48 S. E. 627.

[3] North St. L. Bldg. & Loan Ass. *v.* Obert, *et al.*, 169 Mo. 507; 69 S. W. 1034.

"risk's" duties as secretary of the plaintiff. The bond was not by its terms limited as to its duration. The defendant alleged in its answer to plaintiff's complaint that the bond expired at a certain date prior to the time when most of the defalcations of the "risk" occurred, but the answer did not state any facts from which this conclusion could be drawn. It was held that such statement, being merely a conclusion of law, did not put in issue the question as to the expiration of the secretary's term prior to such defalcation. The court further held that if it appears from all the circumstances that it was the intention of the parties that the bond should cover his acts of defalcation during his continuance in office, whether by reëlection or holding over, then the bond will be construed to cover the "risk's" defalcations according to such intention. In all cases where a "surety company" tries to limit its liability on a fidelity bond to defalcations committed by the "risk" during the unexpired part of the term he is serving when the bond is given, the burden is on it, to so act for the duration of that term.

§ 40. **Effect of Renewal Provision in Policies as to Duration of Liability.** — A renewal of a policy of insurance is in a legal sense a new contract.[1] The provisions of policies containing stipulations for renewal of liability are valid, and the courts will effectuate them in every possible way. In the case of the Official Managers Mutual Guaranty Company *v.* Froane,[2] the plaintiff guaranteed the gross annual returns from defendant's business against loss for a term of two years as against the purchasers becoming bankrupt. The policy contained the following provision:

> "Every guarantee shall be for a specified term, but all guarantees upon gross annual returns, etc., whatever may be the original term, shall, from the expiration of the original return, be treated as a renewal contract of like nature and condition, unless either party gives notice of the intention not to renew."

[1] De Jernette *v.* F. & C. Co., 17 Ky. L. Rep. 1088; 33 S. W. 828.
[2] 7 H. & N. 5.

It was held that in the event of no notice being given the guaranty became a renewed contract for only one period of two years from the expiration of the original term, and not from time to time renewable.

In general it may be stated that, where losses have occurred during each year that a policy is in force, and such losses exceed in the aggregate the amount of the fidelity insurance in force at any one time, in such case the renewal certificates will preclude the insured from recovering more than the face value of the original policy together with interest thereon.[1]

In Guarantee Company of North America *v.* Mechanics Savings Bank and Trust Company [2] the court held that where the policy contained a provision for renewal, as respects time a new contract is made, but that it contained only the terms of the old contract. It is generally held to be a new contract upon the terms and conditions stated in the policy expired; the old application, in the absence of evidence to the contrary, serving as the basis of the new contract, as if made at the time of the renewal. In all such cases, where necessary, the courts will apply the equitable principle of considering that done which ought to be done, and to that end enforce all agreements made by the insurer looking towards a renewal of an expired policy.[3]

A most instructive case on the general subject of "renewal provisions" is De Jernette *v.* Fidelity and Casualty Company of New York.[4] The policy under consideration in that case contained a provision to the effect that the "contract under Bond No. — is hereby renewed in accordance with the terms of the bond, the guaranty to cover the period above named only." The Kentucky court of appeals, referring to this

[1] U. S. Fid. & Guar. Co. *v.* First Nat. Bank of Dundee, Ill. ; 84 N. E. 670.

[2] 80 Fed. 766; 26 C. C. A. 146; reversed on other grounds in 183 U. S. 402.

[3] Lauer, *et al.* *v.* Gray, 55 N. J. Eq. 544; 37 Atl. 53.

[4] 33 S. W. 828; 17 Ky. L. Rep. 1088.

provision, said, that "a renewal of the bond constituted a separate and distinct contract for the period of time covered by such renewal. It is, however, a contract with the same terms and conditions as is evidenced by the bond which is renewed, because the renewal recites that it is renewed in accordance with the terms of the bond. Such contracts standing as separate and distinct contracts, the rights of the parties must be determined under them as such. A renewal of the bond did not alter, change, limit or increase the rights of the parties under the bond; nor did such renewal increase or limit the time for the performance of any act which is required to be done by the parties to ascertain their rights under the bond. When the bond speaks of acts 'committed during the continuance of said renewal thereof,' it has reference to the bond as one contract, and the renewal thereof as other and distinct contracts. For the fraud and dishonesty of the employed during the time covered by the bond no recovery could be had under the renewed contract, nor will the contract, if renewed, enable the assured to maintain an action on the bond, which has been barred by the lapse of time." [1]

In a recent federal case a fidelity bond bound the guarantor to make good and reimburse to the employer any pecuniary loss sustained or occurring during the continuance of the bond or any renewal thereof discovered during such continuance or within six months thereafter. The bond provided that on the issuance of a subsequent bond or renewal thereof the *responsibility* of the insurer on any other bond should cease. The bond was subsequently renewed, the first renewal providing that in consideration of the sum of $25 the insurer guaranteed the fidelity of the "risk" from December 1, 1899 to December 1, 1900, subject to the conditions of the previous

[1] See also Rice v. Fid. & Dep. Co., 103 Fed. 427; 43 C. C. A. 270; Solvency Mut. Guar. Co. v. Freeman, *et al.*, 7 H. & N. 5, 17; 3 H. & N. 588; Am. Cr. Indemn. Co. v. Champion Coated Paper Co., 103 Fed. 609; Indemn. Co. v. Wood, 19 C. C. A. 264; 73 Fed. 81; Am. Cr. Indemn. Co. v. Athens Woolen Mills, 34 C. C. A. 161; 92 Fed. 851; F. & C. Co. of N. Y. v. Lawler, *et al.*, 64 Minn. 144; 66 N. W. 143.

bond, and the second renewal recited that in consideration of a similar sum the guarantee "continued in force," etc. in the sum of $5000. It was held that such renewals did not operate as a continuation of the contract, but that each renewal was a separate and distinct obligation, and that an action could only be maintained for loss sustained and discovered at any time after December 1, 1900, and during the continuance of the last renewal.[1]

In a recent Missouri case[2] a fidelity insurance policy had been issued upon the secretary of a building and loan association. The policy was not by its terms limited in duration. The premium for the first year was paid thereon, and at the expiration thereof the premium for the next year was demanded and paid. Thereupon there was issued what was termed a "renewal bond." Before the expiration of the second year the "surety company" wrote to the insured that if it desired to renew the bond about to expire, a new premium would be required. This the court held was sufficient to show that it was the intent of both parties to the contract of insurance, that the bond was to cover the acts of the "risk" for the period of one year from its date. In support of this holding the court spoke as follows:

"It is contended that if it appears that it was the intention of the parties to the contract that the bond was to cover the acts of the officer not only during the period of the first prescribed term, but also during the period of his actual continuance in office, whether by holding over or by reëlection, the bond will cover such acts according to such intention; and secondly, that the evidence in this case does not show any prescribed term of office, and that the only limitation as to period of liability is to be found in the character of the contract with appellant, which contemplates the annual renewal of the bond upon the payment of an annual premium, whereby the bond runs for the period of one year from the date of its delivery. . . . There is nothing so peculiar in the nature of such a bond as to necessarily limit its op-

[1] Proctor Coal Co. *v.* U. S. Fid. & Guar. Co., 124 Fed. 424; see also Sherman *v.* Harbin, 125 Ia. 175; 100 N. W. 629.

[2] North St. L. Bldg. & Loan Ass. *v.* Obert, *et al.*, 169 Mo. 507; 69 S. W. 1044.

eration to the acts of the principal during his first term. The extent to which we approve the proposition contended for by appellant is that if the term of office is prescribed, and the bond is conditioned without express limitation as to period, for the faithful performance of the "risk's" duties, and nothing else appears to give it wider effect, it will be construed as intended to cover acts occurring only within the prescribed term. We thus by construction read into the bond a limitation as to period. But if it appears from all the circumstances that the intention of the parties to the contract was that the bond, being unrestricted by its own terms, should cover the acts of the principal during his continuance in office, whether by reëlections or holding over, we cannot give it a restricted construction. . . . When it is 'so nominated in the bond,' there is no room for construction; but it is not so nominated in the bond under consideration, and if we give this bond the restricted meaning appellant contends for, we must do so because we are satisfied from the evidence in the case that that was the intention of the parties. When it becomes a matter of construction, it is the duty of the court to put itself in an attitude to view the contract from the same standpoint that it was seen by the parties when they entered into it. . . .

"Respondent also insists that the second bond is in effect but a renewal or continuation for another year of the first bond, like an insurance policy, and in support of this refers to the letter of appellant to Obert, of date February 11, 1897, enclosing the second bond and designating it as 'our renewal bond, No. 26,368 *a*.'

"But that theory will not avail the plaintiff because the penalty of the first, or, as plaintiff would call it, the original bond is exhausted by the recovery on the first count, and there must be a second bond, or else plaintiff can go no further."

Finally, attention is called to the case of the First National Bank of Nashville *v.* United States Fidelity and Guaranty Company.[1] Here a fidelity bond was given to reimburse a bank for loss occasioned by the fraud or dishonesty of its bookkeeper and recited that the insurer would make good to the employer to the extent of seven thousand dollars all pecuniary loss occasioned by dishonesty of the employee occurring during one designated year. A renewal for the following year was given, which recited that it was a renewal bond, subject to the conditions of the original bond. The

[1] 110 Tenn. 10; 75 S. W. 1076.

court held that the renewal bond was a new contract only so far as it extended the indemnity of the original bond to another year, but that there was in fact one bond with one penalty.

CHAPTER VI

SCOPE OF LIABILITY IN FIDELITY INSURANCE

§ 41. **General Remarks on the Scope of the Insurer's Liability under Policies of Fidelity Insurance.** — The phrase "scope of liability" when employed in fidelity insurance has reference to those perils against which the insurer agrees to indemnify the insured in case they occur and operate to the pecuniary disadvantage of such insured. The subject-matter of the scope of the insurer's liability in this immediate connection is originally limited by the elements of time, place, duties, personality and cause. In explanation of the foregoing the following explanatory statement should properly be made.

A loss, which in itself might constitute one of the losses covered by the bond so far as the nature of the act is concerned, may be excluded from the operation of the instrument on account of its having occurred at a time when the bond, by its own terms, had become non-operative.

Again the loss may occur at a place not mentioned in the policy as one where the "risk" was to be located during the life of the policy. Or, on the other hand, the term "scope of liability" may embrace defaults of the "risk" while occupying a position in the employ of the insured other than that named in the policy itself.

Turning next to the element of duties to be performed by a designated "risk," it is apparent that the peril insured against might be far less dangerous from the insurer's standpoint if the "risk" occupied a position of great, rather than one of slight, trust and responsibility. Therefore, no more

important limitations can be placed upon the scope of liability than are imposed by conditions as to the duties and responsibilities of the " risk " who may be designated in the policy of fidelity insurance.

Still again, the scope of liability may be limited to a named " risk," and the loss may occur through the act of some subordinate of the " risk " or through the act of a third party and therefore not covered by the scope of liability set out in the policy. So again, in this connection it should be noted that the personality of the " risk " is a highly important factor in determining whether the insurer will issue the policy asked for or not. The character, antecedents, family history, habits and personal responsibility of the proposed " risk " must all be inquired into before the insurer can determine whether or not it is willing to issue the policy on him or not.[1]

Finally, the element of cause necessarily enters into the question of scope of liability in fidelity insurance. The loss for which reimbursement is sought may arise from a cause not enumerated or it may be one of the excepted causes, and therefore one that cannot properly be brought within the scope of liability. Speaking generally, the causes of liability insured against in fidelity insurance policies embrace some one or possibly all of the perils enumerated in the section which follows.[2] Under the subject-matter of " scope of liability," the discussion thereof will be limited to the specific perils insured against. All the other associated matters referred to above will be considered later on, under the head of " discharge of liability by breach of conditions."

§ 42. **Classification of Perils arising through Acts of the Risk while holding a Position of Private Trust.** — Where the " risk " acts in a private capacity, the perils insured against in a fidelity insurance policy covering his acts in such a position, may be classified as follows:

[1] U. S. Fid. & Guar. Co. *v.* Bank of Commerce, 145 Fed. 144; Clifton Mfg. Co. *v.* U. S. Fid. & Guar. Co., 38 S. E. 790; M. B. & H. Ass. *v.* F. & C. Co., 23 Sou. 405.

[2] § 42, *post*.

Perils arising from Embezzlement, Larceny, Theft, Misapplication of Funds, Misappropriation of Funds, Dishonesty, Actual Fraud, Constructive Fraud, and Negligence.

§ 43. **Liability arising from Embezzlement.** — Embezzlement may be defined to be a sort of statutory larceny committed by a party to whom property has been intrusted by another. It is of statutory, not common law, origin. To constitute the crime there must be in the first instance a material and lawful possession of the same, followed by a conversion of the property to the use of the party charged with embezzlement or to the use of some third party.[1] But whatever may be the definition of embezzlement, either as defined by statute or as determined by the courts, nevertheless the term has a somewhat different meaning and application when employed in fidelity insurance bonds. What this meaning and application is can only be determined by a careful examination of the cases where the term has been before the courts for interpretation.

Embezzlement in common acceptation is a species of larceny and the term is applicable to cases of fraudulent appropriation by clerks, servants or carriers of property coming into their possession by virtue of their employment. It is distinguished from larceny as being committed in respect of property which is not at the time in the actual possession of the owner. Sometimes in fidelity bonds the liability is limited to loss sustained by " any act of fraud or dishonesty amounting to larceny or embezzlement.

The Illinois appellate court, in construing such[2] a clause, spoke as follows:

"It seems clear that in the bonds in this case the words 'fraud or dishonesty' and the words 'amounting to larceny or embezzlement' are both phrases qualifying the word 'act.'

". . . Keeping in mind then the general purpose of these bonds

[1] See Knight v. State, Ala. ; 44 So. 585; Goldman v. Fid. & Dep. Co. of Md., 125 Wis. 390; 104 N. W. 80.

[2] Am. Bond. & Tr. Co. v. N. A. C. Co., 125 Ill. App. 33.

and that the words 'fraud' and 'larceny' and 'embezzlement' in the bonds or policies sued on are used as generic terms to indicate the dishonest and fraudulent breach of any duty or obligation upon the part of an employee to pay over to his employer or account to him for any moneys, securities or other personal property the title to which is in the employer, that may in any manner come into the possession of the employee, we are not justified in resorting to narrow constructions of the provisions of the contract, or in refinements as to the meanings of particular phrases to relieve the insurers from liability on these bonds unless required to do so by the law or the clearly expressed purpose of the contract. The phrase of the bonds quoted above will be read in connection with the next paragraph of the bonds relating to their continuance in force from year to year, which provides that 'in which case the company shall remain liable for any dishonest act of the employee amounting to larceny or embezzlement,' and other provisions of the bonds develops very clearly the purpose and scope of the undertaking as above indicated; and further, that it can make no perceptible difference whether the phrase under consideration relates to the words 'fraud' or 'dishonesty' or 'act.' "

The foregoing construction appears to us palpably wrong in so far as it seeks to limit the application of the words "amounting to larceny or embezzlement" to "dishonesty" alone and not to "fraud." [1]

As to the true meaning of the word "embezzlement," as found in so many fidelity insurance policies, the case of the Milwaukee Theatre Company *v.* Fidelity and Casualty Company [2] should be carefully read. In this case the insurer executed a bond of indemnity to the insured, agreeing to make good and reimburse to the latter to the extent of $6000 such pecuniary loss, if any, as may be sustained by the insured by reason of the fraud or dishonesty of the employed, in connection with the duties referred to, amounting to embezzlement or larceny. The Wisconsin Supreme Court in its opinion in this case spoke as follows:

"So far as necessary to define embezzlement for the purposes of this case, it may be defined as the fraudulent conversion of the money or personal property of another, which is in the possession of a trustee,

[1] See U. S. Fid. & Guar. Co. *v.* Overstreet, Ky. Ct. of App. ; 84 S. W. 764.

[2] 92 Wis. 421; 66 N. W. 360.

servant, agent or bailee in a trust capacity. There can be no embezzlement unless the property charged to have been embezzled was, at the time of the conversion, held in trust. A mere debtor does not embezzle the money of his creditor by failing to pay the debt when due. Did Obermann hold the money in question in a trust capacity, or was he simply the debtor of the plaintiff to that amount? The trial court evidently thought that he had become a mere debtor, and with that conclusion we agree. Interest is compensation for the use of money. When the theatre company resolved that Obermann should pay them interest on the moneys in his hands, and charged him with such interest, and Obermann assented, the necessary implication resulting from the arrangement was that he was to have the use of the money. He was to pay for the use of it. Why should he not have what he paid for? We could not sustain a conviction on these facts, nor have we been referred to any case where such a conviction on similar facts has been sustained?"

The general subject of what acts are sufficient to constitute embezzlement was well considered by the Supreme Court of Maryland in American Bonding and Trust Company *v.* Milwaukee Harvester Company.[1]

Here a fidelity bond had been issued by a guaranty insurance company to the Milwaukee Harvester Company, guaranteeing the latter against fraudulent or dishonest acts of one Brumbaugh, in connection with his duties as general agent for the insured, amounting to embezzlement or larceny. In its opinion in the case the court had occasion to review the action of the trial court in overruling the demurrer to the insured's replication to the insurer's third plea, which alleged that all the moneys collected by Brumbaugh during the term of the bond and the renewal thereof were paid over to the insured, and hence that there was no pecuniary loss sustained by it during the term of the bond sued on. The plea set out a list of accounts collected by the "risk" and alleged that each and all of them were paid over to the insured. The latter denied that the sums of money included in the aggregate of these accounts so collected were paid over to it for and on account of the parties

[1] 91 Md. 733; 48 Atl. Rep. 72.

for whom they had in fact been collected. This for the reason that the insured had been damnified to the full amount of the accounts so collected, amounting to the sum of $2814.85, which constituted an actual deficit in the " risk's " accounts, for which the insurer was liable under the terms of the bond. On this point the court spoke as follows:

"The defendant asked the court to instruct the jury that if they believed that the agent Brumbaugh paid to the plaintiff all the money he collected, including the sum sued for, during the term of the bond and the renewal thereof, then they must find for the defendant, even though they further believe that he directed the company to apply his said payments to accounts other than those from which they were actually collected. The theory of the appellant is, that if all the money was paid, then, first, the plaintiff sustained no loss as contemplated by the bond, and, second, that Brumbaugh's acts did not constitute the crime of embezzlement. This plea did not allege in terms that the acts of Brumbaugh did not amount to embezzlement, but that defence was made by another plea on which issue was joined. The declaration, however, does not specifically charge that Brumbaugh did fraudulently and dishonestly appropriate the sum of $2841.85 of the money of the plaintiff in such a way as to amount to that crime, and this plea undertook to meet the allegations in the narr. by simply alleging that all the money collected during the term of the bond had been paid over, which was replied to by the plaintiff by the allegations that they were not paid on account of the items set out in the plea. The discussion of the point must, therefore, be narrowed to the inquiry whether the fact that the money collected by the agent was paid to the plaintiff although on accounts other than those so collected relieved the agent of embezzlement and the defendant of liability; and giving the plea the greatest possible latitude, we are not called upon to discuss the many technical defences that may be interposed on the charge of embezzlement. It is a statutory crime, and we have a number of provisions in our Code in reference to it. The necessary elements to bring Brumbaugh's acts within the statute are: first, agency; second, receipt of money for, in the name of or on account of his principal as such agent; and, third, a fraudulent conversion thereof. The agency and receipt of the money are conceded, and it is contended that the third element is lacking; but the evidence produced at the trial not being before us, we have nothing to do with the legal sufficiency to sustain the charge, but can only deter-

mine whether the payment as above stated is an answer to it, and relieve the defendant. Independent of authority, we cannot understand how the position of the appellant can be successfully maintained. If Brumbaugh had fraudulently appropriated this money to his own use by paying it to some creditor other than the plaintiff, there could be no question as to the responsibility of the bonding company; and upon what principle can it be relieved merely because he so used it in payment of other debts he owed the plaintiff? If the bonding company had given the appellee one bond to be in effect December 1, 1897, and Brumbaugh had collected from A and B $1000 during the first year which he appropriated to his own use, and during the second year collected from C and D $1000 which he paid to the harvester company to be credited on the accounts of the first year and that company did so credit A and B without any knowledge that the sums were collected from C and D, and there was still a deficit of $1000 at the end of the second year, a suit on the first bond would have been met by the defence that Brumbaugh's obligations were cancelled by the payment so made, and the books of the appellee would have tended to sustain that defence. Then if suit was brought on the second bond, according to appellant's theory it could defeat that action because the money received by the agent during that year had in fact been paid over to the plaintiff. Bonds of this character would be worse than useless if such results could follow, as the party undertaking to be indemnified by them might be misled, and subject to loss, by relying on what he believed to be a security, but which would prove to be a snare and delusion. Or, take another instance. Suppose the agent collected $100 from each of four parties, and paid to his principal $200 to be credited to the accounts of A and B, but kept the balance, and the bonding company was sued for the amounts he received from C and D, could it be possible that it would be a defence to say that the money paid on account of A and B was actually received from C and D and that having been paid to the principal, he could not recover? Or, if the agent was indicted for embezzlement of the money received from C and D, would it avail him to prove that that particular money was paid over to the principal, although it was paid on account of what the agent had received from A and B. If that be true, then if a bank officer appropriates $100 to himself one week, and replaces that with another $100, so appropriated, the next week, and continues that operation from time to time until finally he owes the last $100 which he does not pay, he could not be convicted of embezzlement, or a bonding company could not be held liable on a bond of this character for the last $100 because the agent had paid

that money over to his principal, although he had appropriated the last sum to pay what he previously owed. If Brumbaugh had been the agent of the harvester company for Maryland and Virginia, and the appellant had been his surety for collections in Maryland alone, and another company for those in Virginia, and he had collected $2800 in Maryland which he appropriated to his own use, and afterwards collected $2800 in Virginia, which he paid to his principal to be credited on account of the Maryland collections, would the appellant admit that he was still liable because the money paid was in reality collected from the Virginia debtors? Or would the other company be excused because that money (even if he paid the identical notes received by him) was actually received by the principal, although without knowledge of the source it came from, and was credited by the direction of the agent to the Maryland claims? Other illustrations might be given to show not only how useless securities of this character would be, but the results that might follow if such a doctrine as is contended for be adopted. It might be well said that if A owes B $5, and he surreptitiously takes that amount out of the safe of B and then pays B the debt with it, that it would not be larceny, for he could with equal propriety say that he had not appropriated it to his own use, but had taken it simply to pay B, although he was thereby cancelling a debt he owed him. As the point is now presented to us, the agent used his principal's money received during the term and under the conditions of the bond, and applied it to his own use — that is, to the payment of debts he owed the principal on account of collections previously made by him for which he was liable; and it was therefore as much a conversion of the principal's money as if he had paid it to some other party. He could not successfully defend himself from the charge of embezzlement by reason of such payment, nor can his security do so, under the terms of the bond. There is no allegation that the harvester company was in any way responsible for, or knew of, the use of the money which the appellant was liable for under the bond by Brumbaugh to pay other debts he owed it. If it had been accepted with such knowledge, another question would have arisen.

"If, then, we were without authorities on the subject, we would have no difficulty in reaching the conclusion that the defence intended to be relied on under this plea is not well taken, but those bearing on the question are not wanting. These cases in no way conflict with the general principles applicable to sureties — such as are only liable for defaults, etc., during the time the bonds are in force; but they hold that default is made by the application of money collected under

the terms of the bond to the payment of other debts, even if such debts are due the obligee of the bond, provided, of course, that he is not a party to its misappropriation, and has no knowledge of it." [1]

The question as to what constitutes larceny and embezzlement was gone into quite fully in Monongahela Coal Company *v.* The Fidelity and Deposit Company of Maryland, decided by the United States Circuit Court of Appeals for the Fifth Circuit.[2] In this case an insurance bond had been issued providing for indemnity against loss sustained by the insured of moneys, securities or other personal property belonging to the insured in the possession or custody of the "risk" directly occasioned by larceny or embezzlement on the latter's part. In construing the policy with reference to the scope of liability therein provided for, the court of appeals spoke as follows:

"The bond sued on is one of indemnity, but it is a contract imposing different obligations on the several makers. The plaintiff in error is called in the bond 'the employer,' the defendant in error 'the company' and the J. B. Donnelly Company, Limited, 'the employee.' These terms will be used for brevity. The contract first recites that the employee 'has been required to furnish a bond for his honesty in the performance of his duties in said position' (meaning as agent for the employer). After reciting the consideration and making the other recitals not material here, the agreement is that 'the company shall make good and reimburse to the employer to the extent of ten thousand dollars, . . . all and any pecuniary loss sustained by the employer, of moneys, securities or other personal property belonging to the employer in the possession or custody of the employee, or for the possession of which he is responsible, directly occasioned by larceny or embezzlement on the part of the employee in connection with the duties of the office or position. . . .' It is declared by its terms 'that the true intent and meaning' of the bond are, 'that the company shall be responsible . . . for moneys, securities or property diverted from the employer through fraud or dishonesty on the part of the employee . . .' These provisions all relate to the obligations of the company. From these it appears that the liability of the company is restricted to claims based upon the larceny, embezzlement or at least

[1] See also London Guar. & Acc. Co. *v.* Geddes, 22 Fed. 639.
[2] 94 Fed. 732; 36 C. C. A. 444.

the dishonesty of the employee. The obligation of the company does not cover every liability or claim which might accrue in favor of the employer and against the employee. A loss by carelessness or inattention to business might be the foundation of a just claim against the employee by the employer, which would impose no liability on the company by the terms of its obligations in the bond. If with the consent of the employer expressed or implied from the course of dealings between it and the employee, the latter used or retained moneys, charging itself with them, it would be no obligation covered by the insurance or indemnity of the company. It follows, therefore, that the fact that the account between the employer and the employee shows an indebtedness from the latter to the former is not sufficient of itself to support a claim on the bond against the company. To recover in an action on a bond, defence being made, there must be an allegation of a breach of it, sustained by evidence. There is neither allegation nor proof that the employee has, through fraud or dishonesty, diverted from the employer moneys, securities or other property nor that it has committed larceny or embezzlement of such property. O'Neill and Theis, the only witnesses, testify that the course of business between the employer and the employee was for the latter to transmit the notes of the purchasers for coal sold on credit, and subsequently out of cash sales to retain commissions on account of the sales for which the notes were given. Such dealings made it necessary to keep accounts of debit and credit. Fraud and dishonesty are not to be presumed. The law presumes that every man acts honestly till the contrary is shown. No fact is shown tending to prove that the debt originated in the fraud or dishonesty of the employee. As late as the 20th of April, 1897, O'Neill, the president of the employer company, furnished a certificate that the employee had performed its duties in an acceptable manner, 'and that we know of no reason why the guaranty should not be continued.' The amount of the debt of the employee to the employer is $6634.15. Part of this sum ($1088.64) was collected in 1896. The remainder was collected in April and June, 1897. J. B. Donnelly, Sen., the president of the employee company, died August 29, 1897. The fact that on settlement the employee owed the employer was discovered November 24, 1897, nearly three months after Donnelly's death. Under the circumstances, the fact that the employee, on settlement, is found to owe the employer is not sufficient to show that the debt originated in fraud or dishonesty, in embezzlement or larceny. It is alleged in the petition that the company did 'bond and obligate itself unto your petitioner, in the sum of ten thousand dollars, that it would save, defend and keep harmless your petitioner from and against all

loss and damage whatsoever of any nature or kind, and from all other legal costs and expenses, direct or indirect, incidental thereto which petitioner shall or may at any time sustain.' The bond sued on does not contain this or any similar obligation on the part of the company to the employer. Such language, in substance, is in the latter part thereof, but it is the obligation of the employed [the J. B. Donnelly Company, Limited] to the company [the Fidelity and Deposit Company of Maryland]. That part of the bond is as follows: 'and the said employee doth hereby . . . agree that he will save, defend and keep harmless the said company from and against all loss and damage of whatever nature and kind, and from all legal and other costs and expenses, direct or incidental. . . .'

"This part of the bond is the agreement of the employee to reimburse the company, if it has to pay anything to the employer by reason of the contract. It contains no such obligation of the company to the employer. There was no evidence, in our opinion, before the jury to sustain the allegations of the petition or to justify a recovery of the case. It was proper to direct a verdict for the Fidelity and Deposit Company of Maryland. The judgment of the circuit court is affirmed."

It was claimed by counsel for the "surety company" in a recent Kentucky case,[1] that in order to fix liability on the insurer under a fidelity insurance policy, the insured must produce in support of any claim that it might have arising thereunder, such proof as would be sufficient to convict the "risk" named in the policy of the crime of larceny or embezzlement, as defined by the laws of Kentucky. "Such a narrow construction," observed the Kentucky court of appeals, "of the provisions of the contract is not required by law and was never contemplated by the parties to it. While larceny is a common law crime, yet in this state it is to a great extent statutory. Embezzlement is purely a statutory crime, but the term 'larceny' or 'embezzlement' in the bond or policy sued on are used as *generic terms* and *indicate dishonesty* or *fraudulent breach of any duty or obligation* upon the part of an employee to pay over to his employer the amount he may have in money, securities or other personal property, the title

[1] Champion Ice & Cold Storage Co. *v.* Am. Bond. & Tr. Co., 75 S. W. 197.

to which is in his employer, that may in any manner come into the possession of the employee.[1]

Attention is next called to the case of United States Fidelity and Guaranty Company *v.* Overstreet.[2] In this case a fidelity bond had been executed providing that it was to secure the insured from pecuniary loss of money or property in the possession of a designated "risk" while in the discharge of his duties amounting to larceny or embezzlement committed during the continuance of the bond. The bond further provided that the insured should be responsible only for moneys, securities and property diverted from the insured through fraud of the "risk," amounting to larceny or embezzlement. The insured advanced money, property and credit to the "risk" to enable him to prosecute his work, expecting him to account therefor on final settlement, and engaged to certain of his creditors to be responsible for the "risk's" bills, which were thereafter paid. The "risk" subsequently absconded, having turned over to the insured certain contracts which turned out to be fraudulent, and then appropriated sixteen dollars collected on contracts belonging to the insured. The court held that the latter amount alone was covered by the terms of the bond.

In Baum *v.* United States Surety and Guaranty Company,[3] the court had occasion to discuss the meaning of embezzlement as used in a fidelity insurance policy to the following effect:

"It does not appear that the alleged prosecution is for the embezzlement of the moneys for which the suit is brought, nor that it is conducted in a court of competent jurisdiction, and while it is alleged that this prosecution is pending in the city of Washington, it does not appear that the default set forth in the declaration is there a penal offence. There are essential limitations of the defendant's liability

[1] As to what evidence will be admitted sufficient in law in an action on a fidelity insurance policy to warrant the finding of embezzlement by the "risk," see Goldman *v.* Fid. & Dep. Co., Wis. ; 104 N. W. 80; see also City Tr., Safe Dep. & Sur. Co. *v.* Lee, Ill. ; 68 N. E. 485.

[2] 27 Ky. L. Rep. 248; 84 S. W. 764.

[3] 9 Pa. Sup. Ct. 23.

set up in the affidavit. Whatever the rule in relation to cases *ex delicto* arising from felonious conversion, there is no authority for the proposition that a contract cannot be enforced or that action on it must be suspended because the party in default may by his non-performance have incurred a criminal liability. Moreover the default in the declaration is not necessarily criminal. It may arise from a well-founded and just agreement between the parties respecting the amount payable, or from questions in relation to disputed claims and allowances, or from other causes not criminal."

Again, it was held that defalcations by the secretary of a building and loan association, which were accomplished by his recommendation of loans to fictitious property-holders, the indorsement of the checks issued by the board of directors in pursuance of such purpose with such fictitious names and the subsequent conversion of the funds obtained therefrom to his own use, were embezzlements within the purview of the statute, sufficient to charge a "surety company" on a fidelity bond applicable only to embezzlement or larceny perpetrated within the scope of an officer's duties.[1]

In a recent case,[2] a bond of a surety company was conditioned that if the "risk" should in any manner or by any means misuse, misappropriate or misapply paper or bills to be furnished by the insured, or in any manner dispose of the same or convert the same to his own use, amounting to larceny or embezzlement, then the bond was to be of full force. The "risk" (a corporation) appropriated to its own use a large amount of paper furnished by the insured, and in an action on the bond the insurer claimed that as the "risk" was a corporation, it could not commit larceny or embezzlement, and that therefore the insurer was not liable. The court held that the effect of the bond was to raise a liability under two contingencies: first, if the "risk" should in any manner misappropriate or misapply the paper; and second, if it should, in any manner amounting to larceny or em-

[1] Livingston, *et al. v.* Fid. & Dep. Co., 17 Ohio Cir. 662; *Idem*, 76 Ohio St. 253; 81 N. E. 330.

[2] N. K. Fairbanks Co. *v.* Am. Bond. & Tr. Co., 97 Mo. App. 205; 70 S. W. 1906.

bezzlement, dispose of the same or convert it to its own use.

Attention is called to the case of Guarantee Company of North America *v.* Mechanics' Savings Bank and Trust Company.[1] Here a cashier's guaranty policy stipulated that the "surety company" should make good those losses of the bank (the insured) which might result from such fraudulent acts of Scardt (the "risk") as were equivalent to embezzlement or larceny. The obligation of the "surety company," by its express terms, was limited to that character of wrong-doing upon Scardt's part. The evidence in the case was very explicit that the defalcations of Scardt during the period when his policy was in force, namely from January 1, 1893, to April 17, 1893, was $22,964, of which the sum of $5992 was on account of overdrafts paid by him but not authorized by the bank. "This defalcation," said the court, "even if it had been in some respects fraudulent, must necessarily have been on account of moneys paid out on the checks of customers who had no funds to their credit to meet them; but it is not shown that Scardt embezzled or appropriated any part of the proceeds of these overdrafts, or received any benefit therefrom. If this is true, it is manifest that while Scardt was individually responsible for it to the bank as his principal, no act was done by him which was either embezzlement or larceny, and consequently that the loss was not one which by any fair interpretation would bring it within the obligation of the surety on the bond of Scardt."

To summarize briefly what has preceded, it may be asserted with confidence that the term "embezzlement," as used in fidelity insurance, does not call for the same technical proof of fraudulent acts on the part of the "risk" amounting to the crime of embezzlement as would be required were the latter being prosecuted under the statute for the commission of such crime. While embezzlement is purely a statutory crime, yet

[1] 100 Fed. 559; 40 C. C. A. 442; same case reversed on appeal to the U. S. Sup. Ct. on other grounds, see 183 U. S. 402.

the word as used in fidelity insurance bonds is to be treated as a generic term, and should be held by the courts to indicate dishonesty or fraudulent breach of any duty or obligation upon the part of the "risk" to pay over to the insured any money, securities or other property the title to which is in the insured, that may have been intrusted to the possession of such "risk" by the insured.[1]

§ 44. **Liability arising from Larceny.**—Larceny is the wrongful taking and carrying away by any person of the mere personal goods of another from any place with the felonious intent to convert them to his own use, and to make them his property without the consent of the owner.[2]

While larceny is a common law crime, yet it is in many states to a great extent statutory.[3]

When a bond conditioned for the honest performance of his duties by an employee provides that it shall cover only such dishonest acts of the employee as amount to larceny or embezzlement, there can be no recovery in an action on the bond for any acts or conduct of the employee which failed either of larceny or embezzlement. In an action on such a bond proof that there was a balance due from the employee to the employer and that the former failed to pay the same when demanded is not alone sufficient to render the surety liable.[4]

§ 45. **Liability arising from Theft.**—Theft is really a popular term for larceny.[5] It may be defined as a fraudulent taking of property with intent to deprive the owner of the value of the same, and to appropriate it to the use of the person taking. The taking must be a fraud upon the rights of another, and there must be an actual and intended fraud and not a con-

[1] See Am. Bond. & Tr. Co., *et al.* *v.* New Amsterdam Cas. Co., 125 Ill. Ap. 33; U. S. Fid. & Guar. Co. *v.* E. S. S. & F. Co., 148 Fed. 353.

[2] Ransom *v.* State, 22 Conn. 153.

[3] See Champion Ice & Cold Storage Co. *v.* Am. Bond. & Tr. Co., 115 Ky. 863; 75 S. W. 197; Livingston, *et al.* *v.* Fid. & Dep. Co., 17 Ohio Cir. Ct. Rep. 662; *Idem*, 76 Ohio St. 753; 81 N. E. 330.

[4] Williams *v.* U. S. Fid. & Guar. Co., 105 Md. 490; 66 Atl. Rep. 495.

[5] People *ex rel.* *v.* Donohue, 84 N. Y. 438.

structive or legal one. The crime of theft is not constituted merely by the taking nor the fraudulent taking, but it must also include the purpose and intent to defraud. There must be an intentional taking without the consent of the owner, an intentional fraud and an intentional appropriation, or the crime of theft is incomplete.[1]

§ 46. **Liability arising from Misapplication of Funds.** — Misapplication is a broader term than embezzlement and includes any act which constitutes in legal effect a wilful and wrongful conversion of money, property or effects belonging to another and entrusted to one's care.[2] The word has a settled technical meaning like embezzlement or larceny. The phrase "wilful misapplication" has been defined by the United States Supreme Court to mean "a misapplication for the use, benefit or gain of the party charged or of some corporation or person other than the owner. Therefore to constitute the offence of wilful misapplication, there must be conversion to the use of the party charged or to the use of some one else of the funds of a third party by the one charged with the offence.[3]

It has been said that the word "misapplication" does not necessarily import wilfulness. But as the term is used in fidelity insurance it ordinarily has reference solely to wilful misapplication.[4]

The mere failure of the risk named in a fidelity bond to turn over to the principal on demand property belonging to the principal or the proceeds thereof unaccompanied by other evidence tending to show intentional misapplication is not such a breach of a fidelity bond as to render the surety company issuing the same liable.[5] It cannot be said to constitute misapplication of funds within the scope of liability of a fidelity

[1] Mullins *v.* State, 37 Tex. 337.

[2] Jewett *v.* U. S., 100 Fed. 832; U. S. *v.* Youtsey, 91 Fed. 864; U. S. *v.* Taintor, 28 Fed. Cas. No. 16, 428; U. S. *v.* Fish, 24 Fed. 585.

[3] U. S. *v.* Button, 117 U. S. 655; see also U. S. *v.* Northway, 120 U. S. 327; Batchelor *v.* U. S., 156 U. S. 426.

[4] Sherman *v.* Harbin, 125 Ia. 175; 100 N. W. 629.

[5] T. M. Sinclair Co. *v.* Nat. Sur. Co., Ia. ; 107 N. W. 184.

bond where the "risk" turns over to the insured all sums collected by him after the execution of the bond, notwithstanding the "risk" has credited such sums on the wrong accounts in order to cover up previous defaults.[1]

§ 47. **Liability arising from Misappropriation of Funds.** — Misappropriation is the wilful and wrongful use of money, property or effects, entrusted to the party charged for some particular purpose and by him converted to the use of himself or to the use of others other than the lawful owner. It involves a wilful perversion from the original object or design.[2]

Where an action on a fidelity bond is based upon misappropriation through the failure of the "risk" to account for the proceeds of goods disposed of by him, and the insured makes no complaint as to the manner of disposal thereof, it is not error to forbid the insurer to show directions of the insured to the "risk" concerning the disposal of the goods. Neither was it error under these circumstances to exclude evidence offered by the insurer to the effect that the "risk" afterwards offered to account for the goods so disposed of by him.[3]

Where the articles of a mutual insurance company provided for the creation of a fund to pay the expenses of litigation and the "risk" named in a fidelity bond diverted to that purpose all assessments collected to pay losses, such act is a breach of the conditions of his official bond providing for the faithful discharge of duty.[4]

§ 48. **Liability arising from Dishonesty.** — The term "dishonesty" employed in many of these bonds implies, of course, the reverse of honesty. It signifies lack of probity or integrity on the part of the "risk." It has a broad meaning, including

[1] Model Mill. Co. *v.* Fid. & Dep. Co., 1 Tenn. Ch. Ap. Rep. 365; see also U. P. T. Co. *v.* U. S. Guar. Co., 86 N. Y. Sup. 466; U. S. Fid. & Guar, Co. *v.* Board of Commissioners, 145 Fed. 144.

[2] Winchester *v.* Howard, 136 Cal. 432; 64 Pac. 692; Frey *v.* Toney, 70 N. Y. App. Div. 166; 75 N. Y. Sup. 40; Jackson *v.* Bank, 42 N. J. 177.

[3] Dr. Blair Med. Co. *v.* U. S. Fid. & Guar. Co., Ia. ; 89 N. W. 20; see also Union Pac. Tea Co. *v.* U. S. Guar. Co., 86 N. Y. Sup. 66.

[4] Sherman *v.* Harbin, 125 Ia. 175; 100 N. W. 629.

within its scope acts of thievishness, abuse of confidence, intentional fraud and any intentional deviation from the path of legal rectitude which borders on or is in fact criminal in its nature. In Toronto Bank *v.* European Insurance Company,[1] a policy was issued against losses through the want of integrity, honesty or fidelity, or by the negligence, defaults or irregularities of the "risk," and it was held that where the "risk" allowed certain customers of the insured bank to overdraw their accounts while he knew they were not able to pay the amount of the overdraft, the insurer was liable, particularly on the ground that the "risk" had concealed the existence of these overdrafts from the insured by fictitious returns and in collusion with the parties who were allowed to overdraw.[2]

It has been held in a federal court that in order to give the insured the right to recover under a policy providing for indemnity against loss by reason of fraud, dishonesty, misappropriation or misapplication on the part of the "risk" it is not necessary that such fraud, dishonesty, misappropriation or misapplication amount to a crime.[3] However, a different view of this question was taken by the Supreme Court of South Carolina in the case of Clifton Manufacturing Company *v.* United States Fidelity and Guaranty Company.[4] "It is evident," remarked that court, "that the intention of the 'risk' in his acts respecting this money must have been established before it could be said that he was guilty of fraud or dishonesty as to said funds. A man cannot be found guilty of fraud or dishonesty in absence of a criminal intent."

A bonding company guaranteed the owner against loss by a collector receiving his pay partly in commission. The bond covered only losses sustained through dishonesty or act of fraud of the collector amounting to larceny or embezzlement. It was held that the bonding company was liable for a con-

[1] 14 L. Can. Jurist. 186; 7 Rev. Leg. 57.

[2] See also Am. Sur. Co. *v.* Haynes, 91 Fed. 90; Am. Sur. Co. *v.* Pauly, 72 Fed. 470; 72 Fed. 484; 18 C. C. A. 644.

[3] Am. Sur. Co. *v.* Pauly, 72 Fed. 470; 18 C. C. A. 644.

[4] 60 S. C. 128; 38 S. E. 790.

version of rents by the collector though this did not amount, under the statute, to larceny or embezzlement. The decision was based upon the unsound reasoning that the words "amounting to larceny or embezzlement" did not qualify the word "dishonesty," but only the words "act of fraud."[1]

Where a fidelity bond insured an employer against loss arising from the personal dishonesty of the "risks" who were factors, the mere failure of the latter to turn over to their employer on demand property belonging to the latter or the proceeds thereof was held not to constitute such dishonesty within the meaning of the term as used in the bond.[2]

In another case a "risk" was insured under a bond limiting the liability of the insurer to acts of fraud or dishonesty on the "risk's" part. Goods were shipped by the insured to the "risk" for purpose of sale with the understanding that remittances were to be made every Monday. The "risk" failed to make collections, but did not fail to remit such collections as were made by him. It was held that the bond covered only losses due from acts of actual fraud and dishonesty on the part of the "risk."[3]

Where a "surety company" gave a bond to secure the insured against any loss "by any act of fraud or dishonesty" of the insured's employees, the "surety company" by such bond did not guarantee the payment of the employee's debts contracted while with the insured.[4]

In a suit upon a bond executed to a loan company guaranteeing the honesty of an employee, it appeared that it was stipulated in the application for such bond that the duties of such employee should be to receive and deposit all moneys received by the company, to indorse checks for deposit only and that he was not authorized to sign checks or accept drafts or pay out on account, and that he was without

[1] City Tr., Safe Dep. & Sur. Co. *v.* Lee, Ill. ; 68 N. E. 485.

[2] Sinclair & Co. *v.* Nat. Sur. Co., 132 Ia. 549; 107 N. W. 484.

[3] U. S. Fid. & Guar. Co. *v.* Merkley, *et al.*, Ky. ; 65 S. W. 614; *Idem*, 73 S. W. 1126.

[4] Knitting Mills *v.* Guar. Co., 137 N. C. 565; 50 S. E. 304.

authority to withdraw money. The obligation of the bond was to make good any loss occasioned by fraud or dishonesty of such employee in connection with his duties as specified, and the "surety company" was not to be liable for other than the personal acts of such employee within the direct scope of his specified duties. It was held that the "surety company" was not liable for the dishonesty of such employee in inducing the insured to accept a loan to a fictitious person on fictitious security and procuring the money from the bank where moneys of the insured were on deposit, on a check issued by the insured in the name of such fictitious borrower, by forging his name upon the check.[1] In a recent federal case it was held that the liability on a fidelity bond insuring an employer against loss from the "fraud or dishonesty" of an employee is not limited to such losses as result from his criminal acts, such as embezzlement or larceny, for such words have a broader meaning and include any acts which show a want of integrity or breach of trust.[2]

"The petition" in the case just referred to, it was said, "states a cause of action where it alleges that such treasurer falsely credited himself on the company's books with disbursement which he did not make, making him short in his accounts, and that having authority to execute notes and accept drafts for the company, representing its valid indebtedness and not otherwise, he accepted drafts for large amounts, which it did not owe and used its funds in paying the same, resulting in loss to it through the insolvency of the drawer, all of which acts he concealed from the insured's directors. Commenting on the foregoing facts, the court spoke as follows:

"The test is not whether he intended to personally profit by his course, though that he did is perhaps a permissible inference from the facts shown. He occupied a position of trust and confidence which he secretly betrayed. He received compensation for guarding the interests of his employer, and he was wilfully, intentionally and grossly

[1] Trustees *v.* Fid. & Dep. Co., 76 Ohio 253; 81 N. E. 330.

[2] U. S. Fid. & Guar. Co. *v.* Egg Shippers Strawboard & Filler Co., 148 Fed. 353.

faithless. This is not a case of mere indiscretion or error of judgment. There was a breach of trust, a want of financial integrity, coupled with deceit and concealment and resulting in financial loss to the employer. This was both fraud and dishonesty within the meaning of the bond. Cases involving fidelity bonds insuring against 'embezzlement and larceny' or 'fraud and dishonesty amounting to larceny or embezzlement' are obviously not in point. In the bond before us the terms 'fraud' and 'dishonesty,' while relating to pecuniary matters, are employed in a broader and more comprehensive sense. They are not restricted to such conduct as imports a criminal offence. An act entailing financial loss to another may be both fraudulent and dishonest and yet not fall within the definitions of embezzlement and larceny."

§ 49. **Liability arising from Actual Fraud.** — Fraud has been defined by the courts in general terms as any "artifice whereby another is deceived to his disadvantage." Actual fraud is such fraud as is premeditated, and implies deceit, artifice, trick, designing, in short, some direct operation of the human mind.[1] The general subject of what constitutes fraudulent acts within the meaning of a fidelity insurance bond was considered by the Pennsylvania Supreme Court in a recent case.[2] Here a tailoring firm employed an agent to solicit orders. It was agreed that he should return the clothes not accepted by the persons ordering them within thirty days after they were sent to him, and if they were accepted, he was to collect the money and remit. Clothes were shipped to the agent on his order and he never accounted for them. It was not shown that he ever actually received any of the clothes, or that they had been in his actual control or that he had received any of the proceeds. The court in its opinion spoke as follows:

"The fraudulent and dishonest acts insured against in the contract before us may be classified in two categories; namely, fraudulent and dishonest acts in violation of equity, good conscience and the civil law, and fraudulent and dishonest acts which go beyond that line and subject the perpetrator of them to the penalty of the criminal law. By the express terms of this bond the defendants insured against fraudu-

[1] People *v.* Kelly, 35 Barb. 444.

[2] Reed, *et al.* *v.* F. & C. Co. of N. Y., 42 Atl. Rep. 294; 189 Pa. St. 596.

lent and dishonest acts of the second category only, to wit (as expressed in the bond), those amounting to embezzlement or larceny. Embezzlement or larceny are both terms of the criminal law, and in no respect are they terms of contract law. Therefore unless criminal offences be proven against the 'risk,' the bond does not insure against his acts. Now, what criminal offence has been proved against the 'risk' by the evidence? To test his criminality, a simple device may be resorted to. If he should come into the court here, being on trial for embezzlement or larceny, and hear all the evidence that has been submitted and then say, 'I acknowledge that every word that has been said is true,' notwithstanding that acknowledgment, it would be entirely consistent with his having committed at most a civil offence, and I do not think a conviction could be sustained. Every one of the delinquencies charged to the 'risk' may be due to causes beyond his control and if due to causes under his control, they are entirely compatible with non-criminality. Not one of these goods may, for all we know, ever get to the 'risk's' hands. It is admitted that a large portion of them went to other hands, and the plaintiff himself shipped goods contemporaneously to two places distant from each other, where the 'risk' could not have been physically to take them both at the same instant of time. Wherever the evidence of his receiving them simply shows a constructive receipt of the goods, that is not sufficient to hold a man guilty of a criminal offence. He may have been guilty of a wrong; that is, instead of sending the goods to the customers C. O. D., as he was required to do by his contract, he may have violated this in the belief that he was benefiting his master and concluded that he would send out the goods on credit, relying upon the responsibility of his parties to return the goods that were delivered. This is a wrongful act in view of the contract law. It is a violation of duty, but it is not a criminal offence, if he had no intent to steal or appropriate anything. If he never got the proceeds, and, therefore, could not have appropriated them, then he never did appropriate them. I shall have to enter a non-suit in this case."[1]

Attention is called in this connection to the opinion of the United States Supreme Court in American Surety Company *v.* Pauly.[2] One of the questions before the court in that case

[1] See in general as to meaning of the words "criminal fraud" the following cases: F. & C. Co. of N. Y. *v.* Eickhoff, 63 Minn. 170; 65 N. W. 351; Railroad Co. *v.* Gow, 59 Ga. 685; Bostwick *v.* Van Vorhees, 91 N. Y. 353; Tapley *v.* Martin, 116 Mass. 275.

[2] 170 U. S. 133, 160.

was as to what constituted fraud or dishonesty. The Supreme Court therein approved of the instructions given by the lower court to the jury covering this point. These instructions are in themselves so instructive in this immediate connection that they are given in full.

"I am not going to call attention to that evidence in detail. Suffice it to say that it tends to prove that on or about the 13th of October, the president of the bank procured a discount of certain notes of the bank with the customers' notes belonging to the bank as collateral, to the amount all together of about $45,000; that about that time he sent telegrams in cipher to the cashier of the bank at San Diego; that about that time the cashier caused a credit to be given in the president's personal account for items amounting to about $45,000; that when the bank failed, the apparent balance to the credit of the president in his private account was about $11,000, showing that he had drawn out about $34,000 of the $45,000 which had been placed to his credit on the 13th or 14th of October. It is insisted that this evidence authorizes and requires you to find that the president obtained an improper credit, and by means thereof appropriated more than $25,000 of the funds of the bank.

"I shall not allude to the evidence which has been given as to the president in his personal account with the bank. This is only important as tending to characterize the nature of the transactions of October 13 and 14 and as tending to show the total loss sustained by the bank through its president. But the question for you to determine is whether by reason of these improper credits on the 13th and 14th of October the defendant became liable for a loss within the meaning of the terms of the policy. Was that a fraudulent or dishonest transaction on the part of the president? If it was not, the plaintiff is not entitled to recover. If it was a mere irregularity, or if he was not aware of the fact that these credit items were passed to his account, the plaintiff is not entitled to recover. You must find that when he drew this money out, he knew, or had reason to believe, that these items had been credited to his account; and you must find that in drawing out the money on those credits he was actuated by a fraudulent or dishonest mind. If, upon the evidence in this case, you can come to the conclusion that he believed that if the directors of the bank had known of these transactions, they would have acquiesced and regarded them as entirely satisfactory, why, then it is your duty to find that he was not actuated by a dishonest motive, and therefore his acts in appropriating this money were not fraudulent and dishonest. The burden

is upon the plaintiff to satisfy you by a fair preponderance of evidence of the truth of this issue. Fraud is not to be legally presumed, and the law presumes that every man acts honestly until the contrary is shown. On the other hand, fraud or dishonesty is a condition of the mind. It is incapable of direct evidence. It must always be found from circumstances. There is no way in which the plaintiff could show in what state of mind Mr. Collins was while these transactions were taking place unless he could produce him as a witness on the stand and elicit the truth. Well, as I have said before, the plaintiff has made a *prima facie* case upon this issue, because he has complied with that condition of the policy which prescribes that the written statement of claim shall be *prima facie* evidence of a loss within the terms of the policy. Now it is for you to say, upon the other evidence in the case, which has been decided principally upon the cross examination of the plaintiff's witnesses whether the defendant has overcome that case. If you conclude that the defendant has overcome that presumption, and upon all the evidence before you, that the transactions in controversy are as consistent with the theory of honesty on the part of the president, as of his dishonesty or fraud, then the defendant will be entitled to your verdict." [1]

In a case reported from Kentucky [2] a fidelity insurance policy had been issued insuring the former against acts of fraud or dishonesty on the part of an agent of the insured. Goods were shipped by the insured to the "risk" with the understanding that the remittances were to be made every Monday. The "risk" failed to make collections, but did not fail to remit such collections as were made by him. The question at issue before the court related solely to the meaning of the word "fraud" as used in the bond. The court held that it referred to actual and intentional fraud and therefore did not cover the act of the "risk" (the commission agent) in selling the consigned goods on credit.[3]

Not infrequently the bond issued by the "surety company" limits its liability to only such frauds as amount to larceny or embezzlement. The general effect of this limiting the

[1] See also Am. Sur. Co. *v.* Haynes, 91 Fed. 90.

[2] U. S. Fid. & Guar. Co. *v.* Merkley, *et al.*, Ky. ; 65 S. W. 614; 73 S. W. 1126.

[3] See also Gilbert *v.* Am. Sur. Co., 121 Fed. 499.

character of the fraud for which the surety company is responsible is to frequently read the bond as if it made the "surety company" liable specifically for larceny or embezzlement. Thus where a fidelity bond was executed containing such a clause therein, it appeared that the insured advanced money, property and credit to the "risk" named therein to enable him to prosecute his work, expecting him to account therefor on final settlement and engaged to certain of his creditors to be responsible for the "risk's" bills, which were thereafter paid. The "risk" subsequently absconded, having turned over to the insured certain contracts which turned out to be fraudulent. Prior thereto he had appropriated sixteen dollars collected on contracts belonging to the insured. The court held that the latter amount only came within the definition of fraud, amounting to larceny or embezzlement, and was therefore the only liability covered by the bond.[1]

§ 50. **Perils arising through Constructive Fraud or Dishonesty on the Part of the "Risk."** — Constructive fraud or dishonesty is indirect, and if it exists at all, is to be implied from other acts or omissions to act which may be, in moral contemplation as well as in fact, untainted with intentional fraud or dishonesty, and yet, without the ability or inclination on the part of the party implicated to give or offer proof of his innocence, is legally held to constitute constructive fraud or dishonesty.[2] The circumstances in such a case raise the legal presumption of the existence of fraud or dishonesty, and because it is only presumptive and circumstantial, the courts term it constructive fraud or dishonesty.[3]

Constructive fraud or dishonesty occupies an intermediate position between cases where bonds cover acts of intentional criminality and those relating simply to negligence, care-

[1] U. S. Fid. & Guar. Co. *v.* Overstreet, Ky. Ct. of App. ; 84 S.W. 764; but see City Tr., Safe Dep. & Sur. Co. *v.* Lee, Ill. ; 68 N. E. 485; Am. Bond. & Tr. Co. *v.* N. A. C. Co., 125 Ill. App. 33.

[2] People *v.* Kelly, 35 Barb. 444.

[3] See City Tr., Safe Dep. &. Sur. Co. *v.* F. & C. Co., 58 App. Div. 18; 68 N. Y. Sup. 601; Fairfax *v.* R. R., 67 N. Y. 11.

lessness, etc., on the part of the "risk." A bond exemplifying an agreement to indemnify against acts which may be considered as constructively fraudulent or dishonest was construed and set forth in the case of Fidelity and Casualty Company of New York *v.* Eickhoff.[1] The scope of the policy therein construed by the Minnesota Supreme Court is set forth in the following provisions, to wit, "The company [the insurer] shall, subject to the conditions and provisions herein contained, make good and reimburse to the said employer [the insured] such pecuniary loss as may be sustained by the employer by reason of the fraud or dishonesty of any or either of the employees named upon the said schedule, or added thereto as hereinafter provided, in connection with his duty as receiving agent or buyer [in buying wheat for the employer at a country elevator] provided that the company shall be liable only for the acts of fraud or dishonesty on the part of the persons mentioned in the schedule hereto attached as receiving agents for shortages in their grain account, as follows, to wit:

" There shall be deducted from the total amount of grain and dockage received by the receiving agent at said elevator or elevators screenings and dirt from such grain as has been cleaned at said elevator or elevators, together with the amount of shipments based upon the weights of grain and dockage at terminals; . . . and if the result shows a deficit, and the shortage is not caused by the various exceptions agreed to, this proof of loss will be accepted as binding on the part of the company. In cases where screenings and dirt are burned at the elevator, they shall be weighed before being burned and the weight reported daily to the employer, provided that the company shall not be liable for the grading of grain lost by heating, drying or leakage of cars, or other damage, etc. And it is further agreed that the company shall not be liable for errors or carelessness in the weighing of grain nor for thefts of grain by persons other than those covered by this bond, nor for robbery or theft of money from the person so covered where proof of such error, carelessness, thefts or robbery are conclusive, as negligence is not covered by this bond."

It appears that the acts on the part of the "risk," which gave rise to the claim for indemnity placed by the insured (the

[1] 63 Minn. 170; 65 N. W. 351.

"risk's" employer) with the insurer, arose from the fact that said "risk" during the period of his employment had received nearly one thousand more bushels of wheat than he subsequently delivered to his employer. There was no evidence, other than the existence of the shortage of one thousand bushels of wheat, which tended to establish the actual fraud or dishonesty on the part of the "risk." The claim was made by the attorneys for the "risk" in a suit brought against the latter by the insurer for reimbursement for moneys paid on his account to the insured under the policy, that the latter only covered acts of specific fraud and dishonesty, and that there being no allegation in the complaint that the shortage was caused by the fraud or dishonesty of the "risk," therefore the insurer was under no liability to pay a claim thereunder. This contention was denied by the court in the following language:

"Our construction is that the plaintiff [the insurer] was only bound to make good and reimburse to the elevator company for loss sustained by reason of the shortage of grain caused by the actual fraud or dishonesty of the defendant [the 'risk']; but the bond also provides how the existence and amount of the shortage shall be ascertained, and that when thus ascertained, it shall be accepted as evidence that it was caused by the fraud or dishonesty of the defendant ['risk'] and not by any of the various other causes enumerated in the exceptions for which the plaintiff [insurer] was not to be liable. In other words, that the shortage ascertained in the manner prescribed should be *prima facie* evidence of its existence and that it was caused by the defendant's fraud and dishonesty, thus casting the burden upon the defendant to rebut this *prima facie* case by proof."[1]

Another case in point is that of the School Commissioners *v.* Guaranty Company.[2] In this case the guaranty company had issued a guaranty bond on Evans as accountant and treasurer for the school commissioners, against acts of fraud and dishonesty on the part of said Evans. The latter was arrested for larceny of moneys from the school commissioners, was

[1] See also F. & C. Co. of N. Y. *v.* Crays, 76 Minn. 450; 79 N. W. 531.
[2] 31 L. Can. Jur., 254.

tried and acquitted. Thereafter the school commissioners sued the guaranty company on the theory that liability on the part of Evans or the guaranty company to explain the former's shortage created a case of constructive fraud or dishonesty on Evans's part, and that the policy issued on Evans covered the same. The court, in its opinion, said:

"It appears that it is established in evidence that between the 15th and 26th of September, 1884, Evans received in his capacity as accountant and treasurer for the school commissioners $2,025 and that he had received prior to that time, but since his arrest, another sum of $60; in all $2,085. That he has not rendered account of these sums to the insured, but has simply pretended that said sum was stolen from the safe put at his disposition for the purposes of his employment, which must have been opened by some unknown person, or left open through forgetfulness. It appears that Evans, in the due course of his employment, was required to turn over to the insured all sums received by him for their account, and that his refusal to comply with this duty, without justification on his part, of a fortuitous cause, or by an event of exterior force, putting an end to his responsibility, constituted an act of fraud and dishonesty which it was the express purpose of the guaranty bond of defendant company to cover."

It was held that the explanation given of the matter by Evans and by the insurer was completely insufficient. That the facts proved did not demonstrate in any manner that a robbery had been committed to the detriment of said Evans and without his participation, and that therefore the insurer was liable.

It has been said in this connection that "where one person alone is charged with the duty in his employment of receiving and disbursing funds and of keeping the books of account, and the books of the insured show the receipts of funds of which there is no account of disbursements, the legal presumption is that the person whose duty it was to receive the funds did, in fact, receive them, and, no explanation being made, that he has dishonestly appropriated them to his own use." Such a presumption is of course rebuttable.[1] On the

[1] Guar. Co. of N. A. v. Mut. Bldg. & Loan Ass., 57 Ill. App. 254.

other hand the Supreme Court of Missouri has definitely asserted the principle, "that if a party's conduct is equally consistent with innocence or guilt, the presumption is always in favor of innocence. If an act is as consistent with an honest as a dishonest purpose, the finding must be in favor of the honesty of the transaction.[1] And in Louisville Trust Company *v.* Columbia Finance and Trust Company,[2] it is affirmed that wherever a duty rests upon an individual, in the absence of all evidence to the contrary, it will be presumed that a person intended to do right rather than to do wrong; to act conscientiously rather than with bad faith; to perform his duty rather than to violate it."

In any event it may be said that the courts are extremely loath to construe acts of the "risk" as dishonest or fraudulent, even when declared by the policy to be constructively so, provided they are also consonant with honesty and fairness.[3] Indeed it has been asserted that in order that a "risk" should be guilty of fraud or dishonesty within the meaning of those terms as used in a fidelity insurance policy, a criminal intent on his part must be shown to exist.[4]

§ 51. **Perils arising through Acts of Negligence on the Part of the "Risk."** — Negligence in the law of fidelity insurance is a relative term, and the amount of care necessary to be shown in order to disprove the allegation of such negligence depends upon the peculiar circumstances of each individual case. Thus the fact that the "risk," named in a fidelity insurance bond conditioned upon his diligently and faithfully discharging his duty to the insured, left a large sum of money in open bags while he went to lunch, instead of availing himself of the means of safe-keeping provided for him by the insured, constitutes negligence on the part of the "risk," for which the insurer

[1] Glover *v.* Am. Cas. Ins. & Secur. Co., 32 S. W. 302; 130 Mo. 173.

[2] Ky. ; 60 S. W. 1.

[3] F. & C. Co. of N. Y. *v.* Crays, 76 Minn. 450; 79 N. W. 531.

[4] Clifton Mfg. Co. *v.* U. S. Fid. & Guar. Co., 60 S. C. 128; 38 S. E. 790.

is liable under the insurance bond.[1] A most instructive case in this connection is that of the City Trust, Safe Deposit and Surety Company *v.* Fidelity and Casualty Company of New York,[2] where the court had occasion to construe an insurance bond guaranteeing and indemnifying against loss by reason of the personal dishonesty or culpable negligence of one Wickham as collector-general for the Metropolitan Street Railway. The bond specifically provided that the insurer should not be liable for any act or thing left undone by Wickham in obedience to or in pursuance of any instructions or authorization received by him from the insured, nor for any error of judgment, nor for any injudicious exercise of discretion, nor for any loss by robbery, unless the same should be occasioned by or with the connivance or culpable negligence of said Wickham. The facts in the case were as follows: While Wickham was in the discharge of his duties, conveying money of the insured in canvas bags by wagon in New York City, he had occasion to stop at the Pacific Bank for the purpose of depositing said money there. The wagon drew up to the curb, being driven by one Battey, a fellow employee, who alighted and brought out a small truck from the bank. The street was full of people at the time. Wickham then unlocked the closed wagon, opened the money-box therein and threw the bags near to the front of the wagon, down by the dashboard. He then locked the money-box and placed the canvas bags behind him on the lid of the money-box and handed out to Battey two bags of coin. Battey carried the bags up the stairs to the truck and came back for two more. They were given him, Wickham having meanwhile seen that the canvas bill-bag was safe. After Battey had gone with the second set of bags, a man approached the wagon and said something to Wickham that he could not understand. Wickham at this time looked back again for the bag and it was there, and he

[1] *In re* Cit. Ins. Co. *v.* Grand Trunk Ry. Co., 16 L. J. Q. B. 334, Quebec.

[2] 58 App. Div. 18; 68 N. Y. Sup. 601.

handed Battey, who had returned, the two remaining bags of coin, who then took these into the bank. Turning then again to get the bag of bills, Wickham found that it had disappeared. Wickham thereupon promptly reported the loss. On this state of facts the trial court submitted to the jury the question whether the money was lost through the culpable negligence of Wickham, and in its charge said that if he performed his duty in the premises "imprudently or with a lack of watchfulness which he should have exercised and permitted his attention to be diverted for one instant, upon any pretext, he was guilty of negligence." The court also charged that in order to hold the insurer liable, the jury must find that the loss of the money in question was by or through the culpable negligence of Wickham, defining the term "culpable negligence" as an extreme degree of negligence, stronger and greater than is meant by the ordinary term "negligent." The court further instructed the jury that if they found that Wickham performed the duties with which he was charged at the time when the loss occurred, in pursuance of his judgment, and that such loss occurred solely by reason of the judicious exercise of discretion on his part wherein he was clothed with discretion, either by instructions or by the rules and requirements of the insured, then the verdict must be for the insurer. On appeal the court spoke as follows:

"The charge of the court, that if Wickham permitted his attention to be diverted for one instant upon any pretext, he was guilty of negligence, was erroneous. An examination of the whole charge, however, shows that the court connected these words with what preceded, 'with a lack of watchfulness which he should have exercised,' and immediately after that the court stated that only for culpable negligence on his part could there be a recovery, defining correctly the term 'culpable negligence.' Any wrong impression was therefore removed. The real question was, therefore, whether it appeared that Wickham was guilty of culpable negligence which occasioned the loss of the money. It is argued that there is no specific evidence of such negligence or any negligence; that, taking his story as true, there was nothing shown that he did or left undone, which was an act of negligence; and, moreover,

that the testimony proves that everything he did was in accordance with the custom and rules of the insured as to such work. It is not claimed that there was any defect in the manner in which the work was done, so far as the method of doing it is concerned; and the case must turn, therefore, on whether, from the version given, the inference could be drawn that Wickham was guilty of culpable negligence. It was necessary to prove that Wickham deliberately left the wagon or was directly implicated in the theft. All that the insured was required to prove was that he was culpably negligent. Culpable negligence, however, may be inferred from the circumstances under which, according to Wickham's version and the undisputed facts, the loss occurred. He says he had the canvas bag behind him, and that he occupied the seat and that from there he handed out the coin bags to Battey. At such time he says the bag was taken. As the wagon bed was above the front wheels and there was no step, and the seat was but three feet and four inches, and it was eighteen inches wide, and had a hinged back, behind which the bag was resting, it will be seen that any one to have taken it must have climbed upon the wheel and into the wagon which rested on the springs and reached by Wickham through the narrow space he did not occupy, over the seat and back to where the large and heavy bag had been placed. All this the thief must have done and escaped with the bag without attracting Wickham's attention, for he says he never knew of the loss until the last minute, though he saw the bag but a short interval before. It is inconceivable that the bag could have been taken without the culpable negligence or dishonesty of Wickham. No direct charge is made that he was dishonest, but the only fair and reasonable inference is that he was culpably negligent. The fact of the disappearance of the bag under circumstances described raises a presumption of culpable negligence. The probability of a deliberate plan being conceived by dishonest persons to obtain large sums of money should they be able at any time to outwit those charged with making deposits at the bank, imposed upon the employer of the insured the duty and necessity of exercising active vigilance and care. The mere recital of how that duty was performed on the day of the loss, in our opinion, raises a presumption that care and vigilance were not exercised. The question of whether, upon the evidence, Wickham was guilty of culpable negligence was properly submitted to the jury and after an examination of the record we think that their verdict should not be disturbed."

In a late Canadian case the court had occasion to consider

the scope of the insurer's liability under a policy covering losses by reason or in consequence of the wilful default or culpable neglect of the "risk" in or arising out of his employment with the insured. It was the duty of the "risk" to inspect every week the accounts of the clerks under him; he neglected to do so, and in consequence the embezzlements of a clerk, extending through a year, were undiscovered, and the insured sustained loss thereby. It was held that the loss was covered by the policy.[1]

Finally, attention is called to the case of United States Fidelity and Guaranty Company *v.* Des Moines National Bank.[2] In this case the Des Moines National Bank recovered in the federal circuit court against the United States Fidelity and Guaranty Company judgment in the sum of $5000 upon a fidelity insurance bond whereby, subject to the conditions therein contained, the guaranty company agreed to make good and reimburse to the bank any pecuniary loss sustained by it through the dishonesty or culpable negligence of Eaton C. Kelley, its receiving teller, in connection with the duties pertaining to that position and for which the employee shall be legally liable to the employer. To secure a reversal of the judgment the guaranty company sued out its writ of error.

One of the conditions of the bond was this:

> "The company shall not be liable hereunder for any loss occasioned by mistake, accident, error of judgment on the part of any employee or any robbery unless by or with the connivance or culpable negligence of the employee; and culpable negligence as used in this bond shall be taken and held to mean failure to exercise that degree of care and caution which men of prudence and ordinary intelligence usually exercise in regard to their own affairs."

In different portions of the court's charge to the jury the degree of care and caution, failure to exercise which constituted culpable negligence within the meaning of the bond, was

[1] Colonial Bank *v.* European Ins. & Guar. Soc., 1 Wyatt, Can. 15; see also Ionides *v.* Ins. Co., 32 L. J. (C. P.), 170.

[2] 145 Fed. 273.

declared to be the very highest, — you might almost say the highest possible,—and an extraordinary and very high degree.

"This was excepted to at the time and is assigned as error. The exception was well taken. The terms of the contract which were perfectly plain did not call for the exercise by the employee of the very highest or an extraordinary degree of care and caution, but only such as men of ordinary prudence and intelligence usually exercise in regard to their own affairs. That the two things are not substantially the same, but essentially different, and that the charge conveyed to the jury an enlarged idea of the right of the bank and of the obligation of the guaranty company, are self-evident propositions. Again, the trial court charged the jury as follows :

"Now whether the money was there Saturday evening (August 23) the evidence does not of course show. The evidence does not show when that $5000 disappeared, and the evidence does not show who took the $5000. The evidence does not show whether it was stolen or whether it disappeared through some act of carelessness in the shipment of money, or something of that kind; that is very largely a matter of conjecture, how it got out of there. But it disappeared, and the bank was and is short $5000 from its reserve fund.

". . . Now, while there is no proof that Mr. Kelley stole this money, and it is not claimed that he did by counsel for plaintiff, you have a right to consider the facts that either somebody stole this money or else it was gotten away with by the negligence of some one in sending it or shipping the money out to some other bank or somehow or other, and the recipient of the money not making the mistake known. Now, it has been argued that because he did not count the money on each evening it cannot be said that the loss resulted from that. In one sense that is true, but in another sense that is very material. If he had counted the money each evening as instructed and directed by his superior officer, namely the cashier, Mr. Zwart, the loss of the money would have been earlier ascertained. . . . Before the money was counted Mr. Kelley relieved Mr. Collins from the duties of that place. The $5000 of the money was gone when Mr. Collins came back to take his place. Therefore, you are warranted, not necessarily so, but you would be warranted in reaching the conclusion that while the method, or cause of this loss, is not shown, you would be warranted in finding that the money was lost by his negligence, by his blamable negligence, by his failure to exercise the degree of care that you would expect of me or anybody else entrusted with that amount of money. . . . The plaintiff bank has the burden of proof to show this negli-

gence or culpable negligence as expressed in the policy as charged in the petition; but while that is true and when the facts are all made known, you have the right to infer from all of these circumstances that in some way or other, without disclosing the particular way, that this money was lost through his negligence; and the fact that other employees could go in and out of there and that they could have taken it, all these throw but very little light upon it. . . . This money was put there in Mr. Kelley's possession and debited to him on the books, showing he was in the care and control of it.

"Thus the charge proceeded upon the view, that while the matter of when and how the loss occurred and what became of the money were not shown, but left to conjecture, Kelley's relation to the money, his control over it and his custody of it were such that the jury were justified in inferring that the loss, because not shown to be otherwise, was in some way or other the result of culpable negligence on his part. Essentially the same idea is expressed by counsel for the bank when they say:

"'We contend that by the manner of procedure in this bank and the system of accounting in vogue in this bank, we have shown conclusively that Kelley got the money and can't tell what became of it, and so his bond is liable unless they show what became of it.'

"We cannot concur in that view. It presupposes that the reserve cash was within the control and custody of Kelley and applies to him the rule applicable to a bailee or other custodian whose situation is such that a loss, if not otherwise explained, warrants the inference that it was due to his negligence or dishonesty. Kelley occupied no such relation to this money. He could take from it to replenish the counter cash and add to it from the latter, and it was his duty to count it at the close of each business day and then to lock the safe, but in other respects it was not within his control or custody. It was the cashier and not Kelley who carried the combination to the lock, who could say whether the reserve chest should be kept locked or unlocked during business hours and who could otherwise take measures for the safety of the money. When Kelley was tending to his duties in the paying teller's cage, as was required most of the time, the reserve chest and its contents were beyond the range of his observation. The chest was unlocked and its contents were easily accessible to other employees over whom he had no control and who were passing in and out of the vault and sometimes out of the bank without any supervision of their movements. True, they had no right to disturb the money, but there was no assurance that none of them would yield to the temptation which

the situation presented; nor does the presumption of innocence, which would protect them from the charge of theft in the absence of satisfactory evidence thereof, warrant the inference that Kelley was either negligent or dishonest. Such an inference cannot be legitimately drawn from a rebuttable presumption, but only from premises which are certain."

An instructive case is that of Northern Insurance Company of England *v.* Borgelt, *et al.*[1] In this case insurance agents procured a fidelity bond for the benefit of their principal, which was conditioned that they should in all respects observe the instructions of their principal and that they should in all respects well and faithfully perform their duties as such agents. Thereafter the agents neglected to cancel a policy when directed to do so and the company issuing the same (the principal) was afterwards compelled to pay a loss upon the policy. The court held that it was the duty of the "risk" named in the bond to make good any loss which accrued to the insured either through neglect or violation of instructions. This being so, the condition of the bond was broken when the "risk" failed to repay to the insured the amount which the latter was compelled to pay on account of their negligence.[2]

CHAPTER VII

DISCHARGE OF LIABILITY BY RESCISSION AND CANCELLATION OF THE POLICY

§ 52. **General Remarks on the Discharge of the Insurer's Liability.** — With the policy duly written and delivered to the insured, the question then arises, How may the insurer's liability arising therefrom be discharged? To answer this query in briefest form, it may be said that the insurer may be relieved from liability under a policy of fidelity insurance in any one of the following enumerated ways:

[1] Neb. ; 93 N. W. 226.
[2] See also Sherman *v.* Harbin, 125 Ia. 575; 100 N. W. 629.

I. By rescission of the policy, either by mutual consent or under provisions in the policy giving such right to the parties thereto.

II. By cancellation of the policy under decree of court.

III. By misrepresentation on the part of the insured.

IV. By concealment on the part of the insured.

V. By breach of warranty on the part of the insured.

VI. By breach of conditions on the part of the insured.

VII. By settlement of the loss, if any, which is made the basis of a liability asserted by the insured against the insurer.

VIII. By release of the insurer's liability through acts of the insured.

§ 53. (I) **Discharge of Liability by Rescission of the Contract of Fidelity Insurance.** — Rescission of the contract of fidelity insurance may occur either through mutual consent or under stipulations in the policy inserted for that purpose.[1] Parties to the contract of insurance have undoubtedly the same right to abrogate the agreement that they had to make it, and when they mutually agree to end it, it is to be treated as if it never existed.[2]

Where provisions in the policy are inserted providing for rescission of the contract at the option of either one or both of the parties thereto, such stipulations are unquestionably valid and enforceable in all cases where no liability has been incurred under the policy at the time notice of rescission is sent.[3]

Sometimes such a contingency as is here referred to is expressly provided for in the policy by the insertion of some such clause as the following:

"That if the insurer shall so elect, this policy may be cancelled at any time by giving one month's notice to the insured and refunding the premium paid, less a *pro rata* part thereof, remaining liable for all

[1] Rice *v.* Fid. & Dep. Co., 103 Fed. 427; 43 C. C. A. 270; Ætna Indemn. Co. *v.* Auto Traction Co., 147 Fed. 95.

[2] F. & C. Co. *v.* Goff's Exec., 17 Ky. Law Rep. 214.

[3] See Am. Sur. Co. *v.* Thurber, 60 N. Y. Sup. 198; 43 App. Div. 528; 162 N. Y. 244.

or any default caused by the 'risk' up to the date of such termination, and discovered and notified to the insurer within the limit of time hereinbefore provided for."

In the absence of fraud or statutory authority therefor, the power to forfeit an insurance policy must be nominated in the bond.[1]

§ 54. (II) **Discharge of Liability by Cancellation of the Policy under Decree of the Court.** — Ordinarily, in the absence of mutual acquiescence or express reservation in the policy of the right of withdrawal, neither party to the contract of insurance can withdraw from the engagement thereby entered into.[2]

However, there is no doubt that, on application to the court, the insurer may, prior to the incurrence of liability under the policy, relieve itself from future liability thereunder on a number of well-recognized equitable grounds. Among these might be mentioned fraud on the part of the insured in obtaining the policy in the first instance, mistake on the part of the insurer or the pursuit of a line of conduct on the part of the "risk," with the connivance of the insured, calculated, if continued in, to result in the insurer's becoming liable therefor to the insured under the policy.[3]

But after a loss has occurred, and the liability of the insurer has become fixed within the life of the policy, it is then too late to exercise the right of rescission. Such delay constitutes in law a waiver of any right to rescind which otherwise the insurer may have had, and would render the insurer guilty of such laches as would estop it from exercising the right of cancelling the policy.

In American Credit Company *v.* Wimpfheimer [4] the insurer

[1] See Arnold *v.* E. M. A. L. Ins. Co., Ga. ; 60 S. E. 470.

[2] Am. Sur. Co. *v.* Thurber, 60 N. Y. Sup. 198; 43 App. Div. 528; 162 N. Y. 244; People *ex rel. v.* Feitner, 176 N. Y. 129; Arnold *v.* E. M. A. L. Ins. Co., Ga. ; 60 S. E. 470; F. & C. Co. *v.* Goff's Exec., 17 Ky. Law Rep. 214.

[3] U. S. Fid. & Guar. Co. *v.* First Nat. Bank of Dundee, 233 Ill. 475; 84 N. E. 670; Herbert *v.* Lee, *et al.*, 118 Tenn. 133; 101 S. W. 175.

[4] 14 N. Y. App. Div. 498; 43 N. Y. Sup. 909.

sought to obtain a decree of the court cancelling a credit insurance bond on the ground of fraud in that the insured concealed material facts from it when the bond was issued. The insurer tendered back the premium and demanded the surrender of the bond. The court in its opinion remarked that "fraud in the suppression of a material fact arises where only one party to the contract fraudulently and intentionally conceals from the adverse party something which he knows, and which the other party does not know, and which the first party was bound to state, the suppression of which has induced the adverse party to enter into a contract. *Suppressio veri*, or concealment, will amount to fraud where the concealment is of material facts, where there is such a relation of trust and confidence between the parties that the one party is under some legal or equitable duty to give full information to the other, and which the latter has a right, *juris et de jure*, to know, and then the withholding of such information purposely may be a fraud. Where the parties deal at arm's-length on equal terms, and no particular relation of trust or confidence exists between them, there is usually no obligation to speak, and either may remain silent and be safe." [1]

As already observed, there seems to be no reason why, on proper application to a court having jurisdiction in the premises, the insurer might not be relieved from further liability under its policy on the ground of misconduct on the part of the insured of such a nature as might reasonably be calculated to induce fraudulent and dishonest acts on the part of the "risk." [2]

As an example of the character of the acts here referred to, the retention of the "risk" in the insured's employ after knowledge that he had embezzled funds of the insured might be given. Such a course of conduct would certainly prevent

[1] See also Am. Bond. & Tr. Co. *v.* L. S. Va. Gas Co., 95 Fed. 49; Ætna Indemn. Co. *v.* Auto Traction Co., 147 Fed. 95.

[2] U. S. Fid. & Guar. Co. *v.* First Nat. Bank of Dundee, 233 Ill. 475; 84 N. E. 670.

the insured from recovering for a loss of funds entrusted to the " risk " after such knowledge had come to him.[1]

Among the grounds for the seeking of relief either at law or equity from liability under a policy, which are to a greater or less extent open to the insurer, the following may be mentioned:

First. Fraud in obtaining the policy.[2]

Second. Absence of valid insurable interest in the insured.[3]

Third. Change in the composition of the insured during the life of the policy.[4]

Fourth. Want of personal integrity and indulgence in vicious and immoral habits on the part of the "risk" has been said to afford ground for granting a request of the insurer for relief from liability under a judicial insurance bond.[5]

Fifth. The transaction of illegal business or the performance of *ultra vires* acts on the part of the insured, affecting the " risk" named in the policy during the life thereof.[6]

Sixth. The insolvency of the insured during the life of the policy.

Seventh. The insolvency of the insurer, occurring prior to the expiration of the policy.[7]

[1] See Globe Sav. & Loan Co. *v.* Emp. Lia. Assur. Corp., 13 Manitoba L. R. 531; Monongahela Coal Co. *v.* Fid. & Dep. Co., 94 Fed. 732; 36 C. C. A. 444.

[2] Tarpey *v.* Secur. Tr. Co., 80 Ill. App. 378; Secur. Tr. Co. *v.* Tarpey, 182 Ill. 52; 54 N. E. 1041; U. S. Fid. & Guar. Co. *v.* Blakely Hurst & Co., 117 Ky. 127; 77 S. W. 709; Ætna Indemn. Co. *v.* City of Haverhill, 142 Fed. 125; U. S. F. & G. Co. *v.* First Nat. Bank of Dundee, 233 Ill. 475; 84 N. E. 670.

[3] McCanna & Fraser Co. *v.* Cit. Tr. & Sur. Co., 76 Fed. 420; 24 C. C. A. 11; Mut. Bldg. & Homestead Ass. *v.* Fid. & Dep. Co., 50 La. 291; 23 Sou. 405; Ger. Am. Tit. & Tr. Co. *v.* Cit. Tr. & Sur. Co., 190 Pa. 247; 42 Atl. 682; Clifton Mfg. Co. *v.* U. S. Fid. & Guar. Co., 38 S. E. 790.

[4] Nat. Sur. Co. *v.* T. B. T. B. & C. Co., 74 Ill. App. 312; 186 Ill. 156; 52 N. E. 938; M. B. & H. Ass. *v.* Fid. & Dep. Co., 50 La. 291; 23 Sou. 405; Carstairs *v.* Am. Bond. & Tr. Co., 116 Fed. 449.

[5] Nat. Sur. Co. *v.* Morris, 111 Ga. 307; 36 S. E. 690.

[6] See Gilbert *v.* Am. Sur. Co., 121 Fed. 499; M. & T. Co. *v.* Cit. Tr. & Sur. Co., 74 Fed. 597; 76 Fed. 420.

[7] See Smith *v.* Ins. Co., 65 Minn. 283; Gray *v.* Reynolds, 37 Atl. 461.

Eighth. Incorporation of the insured after the policy is issued to them as individuals.[1]

CHAPTER VIII

(III) DISCHARGE OF LIABILITY BY MISREPRESENTATIONS

§ 55. **Misrepresentations defined and discussed.** — The word "misrepresentation" as herein used will be given a somewhat more restricted meaning than the same term has in other branches of insurance law. As here employed, it may be defined as an oral or written statement preceding the contract of insurance, that is either made directly to the insurer by the insured, or by the "risk" to the insurer with the insured's indorsement as to its truthfulness, of some fact material to the proposed assumption of liability, which is either known to be untrue and is stated with intent to mislead, or which is stated positively as true without adequate knowledge as to the same, and which has an inherent tendency to induce the insurer to assume a liability which ordinarily, had the real facts been known, it would have declined. From the foregoing definition it is apparent that the doctrine of misrepresentation is but little more than an extended application to contracts of guaranty insurance of familiar equitable principles relative to fraud.[2]

[1] See generally on the right to rescind policies of guaranty insurance the following cases: Ripley Bldg. Co. *v.* Coors, 37 Col. 78; 84 Pac. 817; York City School Dis. *v.* Ætna Indemn. Co., 131 Fed. 131; Hanley *v.* U. S. Fid. & Guar. Co., 131 Mich. 601; 92 N. W. 106; Ætna Indemn. Co. *v.* Am. Tr. Co., 147 Fed. 95; Romine *v.* Howard, *et al.*, Tex. ; 93 S. W. 690; Am. Bond. & Tr. Co. *v.* B. & O. S. W. Ry. Co., 124 Fed. 866; *In re* U. S. Fid. & Guar. Co., 98 N. Y. Sup. 217; 50 Misc. 147; U. S. Fid. & Guar. Co. *v.* Peebles, 100 Va. 585; 42 S. E. 310; Fid. & Dep. Co. *v.* Moshier, *et al.*, 151 Fed. 806; *In re* Pope's Estate, Me. ; 69 Atl. 616; Rich & Bros. *v.* Fid. & Dep. Co., 126 Ga. 461; Clarke *v.* Am. Sur. Co., 171 Ill. 235.

[2] See Am. Cr. Ins. Co. *v.* Wimpfheimer, 14 N. Y. App. Div. 498; 43 N. Y. Sup. 909; Brillon Lumber Co. *v.* Barnard, 131 Wis. 284;

It may be stated generally that the doctrine of misrepresentation, so important in other branches of insurance law, has to-day, by reason of a custom now almost universal, but little practical importance in fidelity insurance. The custom to which reference is here made consists in inserting clauses in all policies of fidelity insurance issued, whereby all representations contained in proposals or applications are thereby transformed into express warranties. By the foregoing statement it must not be understood that the doctrine of misrepresentation as it exists in general insurance law has not a well-recognized place in the domain of guaranty insurance. In point of fact the contrary is true.[1]

To ascertain what in the law of guaranty insurance constitutes a representation it is necessary to call attention first of all to certain features of this branch of insurance law not common to all lines of insurance. This is the existence of two sets of representations: one contained in the "application" of the "risk" and the other found in the "proposal" of the insured. Where, in accordance with almost universal practice the application is indorsed by the insured, who in terms declares that the answers in the application made by the "risk" for a guaranty policy are true, "to the best of his knowledge and belief," the legal effect is more nearly identical with that of similar statements contained in the proposal than when the application is unaccompanied by any indorsement thereof on the part of the insured. In the latter case the falsity of the answers in the application cannot, under any circumstances, be held to preclude recovery on the policy. The truth of this is obvious; the insured was not a party to the misrepresentations, if any are therein contained, and is not presumed to know of the existence of the representations

111 N. W. 483; Globe Sav. & Loan Co. *v.* Emp. Lia. Assur. Corp., 13 Manitoba L. R. 531; U. S. Fid. & Guar. Co. *v.* E. S. S. & F. Co., 148 Fed. 353.

[1] See U. S. Fid. & Guar. Co. *v.* First Nat. Bank of Dundee, 233 Ill. 475; 84 N. E. 670; Willoughby *v.* Fid. & Dep. Co., 16 Okla. 546; 85 Pac. 713; Fid. & Dep. Co. *v.* Guthrie Nat. Bank, 17 Okla. 397; 87 Pac. 300.

contained in the application. Even where the policy itself refers to such application and to such representations, it would be necessary, it is believed, in order to avoid liability, for the insurer to show the fact that such application and such representations had been made and were brought to the attention of the insured in some direct manner. The foregoing is clearly established by the decisions.[1]

The doctrine of misrepresentation in fidelity insurance should be strictly limited to statements made prior to the inception of the contract itself and not incorporated therein. Thus where "representations" are referred to herein, reference is had exclusively to statements preceding the contract of insurance, and consisting either of such statements when made by the "risk" in his "application," by and with the knowledge and approval of the insured, or by the latter directly in his "proposal" for insurance, none of which are referred to in the policy as the basis of the same or warranted as to their truthfulness, in any manner by the terms of the contract subsequently entered into between the parties. The general rule in guaranty insurance is that statements or declarations by the insured will be regarded in law as representations and not warranties unless the contract makes them so.[2] Sometimes, however, the inference to be gathered from a reading of the policy is so strong that it was intended to make the representations of the "application" or "proposal" part of the policy as to compel the conclusion that they are incorporated therein.[3] For when they are so referred to or warranted, they thereby cease to be treated as representations and become warranties.[4]

No better statement of the legal distinction that exists

[1] Sup. Cl. etc. *v.* F. & C. Co. of N. Y., 63 Fed. Rep. 48; 11 C. C. A. 96; Towle *v.* Nat. Guar. Ins. Co., 7 Jur. N. S. 1109; U. S. Fid. & Guar. Co. *v.* E. S. S. & F. Co., 148 Fed. 353.

[2] Am. Bond. & Tr. Co. *v.* Burke, *et al.*, 36 Col. 49; 85 Pac. 693; M. K. & T. Tr. Co., *et al. v.* German Nat. Bank, 77 Fed. 117; 23 C. C. A. 65.

[3] Dime Sav. Inst. *v.* Am. Sur. Co., 68 N. J. Law 440; 53 Atl. 217.

[4] U. S. Fid. & Guar. Co. *v.* E. S. S. & F. Co., 148 Fed. 353.

between representations and warranties has been made than that given in the able opinion of Judge Sanborn in Rice *v.* Fidelity and Deposit Company of Maryland.[1] In presenting the opinion of the court in that case, which was an action brought by the insured to recover on a fidelity insurance policy, he used these words:

"The terms 'representations' and 'warranties' are imported into this case from the law of insurance. Under the law upon that subject they generally and properly describe statements of existing facts, not promises or prophecies regarding future acts. In insurance a 'representation' is a statement by the applicant to the insurer regarding a fact material to the proposed insurance, and it must not only be false, but fraudulent, to defeat the policy. A representation is a mere declaration of a fact, but it is neither a condition precedent nor a part of the contract. The crucial distinction between a representation and a warranty is that one is not and the other is a part of the contract between the parties and that the truth of the one is a condition precedent to a recovery on the policy or bond to which they relate."

The general rule is that unless the representations are made warranties, then, unless such representations are known to be untrue when made, their material falsity does not prejudice the rights of the insured.[2] The courts have occasionally refused to hold that mere negligence on the part of the insured in failing to properly verify in any proper manner the truth of such representations may in itself be offered as a defence to an action on a policy of fidelity insurance.[3] But not infrequently a different rule has been enunciated.

Thus much more advanced ground than has heretofore been taken by any of the courts in this connection will appear upon a reading of the case of the United States Fidelity and

[1] 103 Fed. 427; 43 C. C. A. 270, 8th Cir.

[2] Trustee *v.* Fid. & Dep. Co. of Md., 76 O. St. 253; 81 N. E. 330; Willoughby *v.* Fid. & Dep. Co. 16 Okla. 546; 85 Pac. 713; First Nat. Bank *v.* U. S. Fid. & Guar. Co., 110 Tenn. 10; 75 S. W. 1076; U. S. Fid. & Guar. Co. *v.* First Nat. Bank of Dundee, 233 Ill. 475; 84 N. E. 670; Fid. & Dep. Co. *v.* Guthrie Nat. Bank, 17 Okla. 397; 87 Pac. 300.

[3] Trustee *v.* Fid. & Dep. Co. of Md., 76 O. St. 253; 81 N. E. 330; First Nat. Bank of Nashville *v.* U. S. Fid. & Guar. Co., 110 Tenn. 10; 75 S. W. 1076.

Guaranty Company *v.* Blakely Hurst and Company.[1] In this the court held that a fraud may be perpetrated as well by the bare assertion of facts that do not exist, innocently made by one whom a person, acting upon such an assertion, has the right to suppose used reasonable diligence to inform himself, as by concealing facts known to exist which in equity and good conscience should have been disclosed. The court further held that the law requires the insured who makes material representations for the purpose of inducing another to issue a fidelity bond, something more than the mere belief on his part of the truth of such representations. His duty under such circumstances requires that before making such representation he should use ordinary care to know that it is true. The Supreme Court of Wisconsin in Brillon Lumber Company *v.* Barnard[2] has taken substantially the same ground as the Kentucky court of appeals in the case just above cited. In the case last referred to it was held that if the obligee knowingly makes false representations as to material facts to the obligor in response to inquiries by the latter, or if the obligee does so negligently, or under such circumstances as would undoubtedly lead the inquirer to believe the representations to be based on an investigation, and the proposed surety is thereby induced to sign the bond, the latter may avoid liability thereon on the ground of fraud. But an innocent false representation in such a case, such as the assertion of a mere opinion or the substance of a fact not derived from investigation, nor made under such circumstances as to suggest such derivation, but made through mere ordinary negligence, is immaterial.

A few general remarks on the subject of representations in fidelity insurance may be of some service at this point. One salutary rule that seems to prevail is that statements in applications tending to show the extent and scope of liability must be answered with great candor.[3]

[1] 117 Ky. 127; 77 S. W. 709.

[2] 131 Wis. 284; 111 N. W. 483.

[3] See Phil. Horse Car Co. *v.* F. & C. Co., 160 Pa. St. 350; 28 Atl. Rep. 823.

A representation which is a part of a copy of the application made to another insurer, and which was true when made, no one being deceived by it, cannot be regarded as false in the sense of being an attempt to deceive.[1]

Where the application is not made a part of the contract, and the policy does not make the representations therein contained a warranty, their materiality and truth are for the jury.[2] So also is the question whether there has been a substantial compliance therewith.[3]

Where representations are made by the insured to the insurer in response to questions submitted by the former to the latter, preceding the issuance of a fidelity insurance bond, the rule is that such representations must be made in good faith, otherwise any material falsity therein will relieve the insurer from liability.[4] Misrepresentations need not, like warranties, be strictly and literally complied with, but only substantially, and in those matters which are material to be disclosed to enable the insurer to determine whether it is willing to issue a policy of fidelity insurance.[5]

Occasionally attempts have been made by legislative bodies to prevent, — except under certain conditions — fidelity insurance companies from escaping liability on the ground of misrepresentation. The effect of such legislation was considered in London West *v.* London Guarantee, etc. Company.[6] The Ontario Insurance Corporation Act, October, 1892, provided that no contract of insurance made or renewed after the commencement of such act should contain any proviso providing that such contract should be avoided by reason of any statement in the application therefor, as inducing the entering into of the contract by the corporation, unless such

[1] Tarpey *v.* Secur. Tr. Co., 80 Ill. App. 378; Secur. Tr. Co. *v.* Tarpey, 182 Ill. 52; 54 N. E. 104.

[2] Penn. L. Ins. Co. *v.* Mech. Sav. Bank & Tr. Co., 72 Fed. 413.

[3] First Nat. Bank *v.* U. S. Fid. & Guar. Co., 110 Tenn. 10; 75 S. W. 1076.

[4] Fid. & Dep. Co. *v.* Guthrie Nat. Bank, 17 Okla. 397; 87 Pac. 300.

[5] First Nat. Bank of Nashville *v.* U. S. Fid. & Guar. Co., 110 Tenn. 10; 75 S. W. 1076.

[6] 26 Ont. Rep. 520.

proviso should be limited to cases in which such statement is material to the contract, and that no contract within the intent of said section of said act should be avoided by reason of the inaccuracy of any such statement unless it be material to the contract. It was held, first, that a policy against loss by reason of fraud or dishonesty on the part of the employee was a contract of insurance; and secondly, that the same could not be avoided by reason of misstatements in the application therefor, under a stipulation of the contract providing for the avoidance thereof for such misstatements, where there was no provision that the same should be limited to cases in which such misstatements were material to the contract.[1]

In a Kentucky case it was held that where the statute provided that all statements or admissions in the application for insurance should be deemed representations and not warranties, and should not prevent a recovery on the policy unless fraudulent or material, that such statutory provision did not alter the vitiating effect of material false representations.[2]

Still again, attention is called to the Tennessee statute,[3] which provided that any representation or warranty made in any negotiations for a contract or policy of insurance, or in any application therefor, should not be deemed material or operate to defeat the policy unless the representation was made with actual intent to deceive, or unless it increased the risk of loss. This statute was held to apply to fidelity bonds, and the question whether representations of a bank cashier, made to a fidelity company during the negotiations for the issuance of the bond insuring the fidelity of an employee of the bank, were true, was for the jury. It was also held that the finding of a court of chancery that the statements made by such bank cashier to a fidelity company previous to the issuance by it of a bond to indemnify the bank for loss occasioned by the fraud or dishonesty of a bookkeeper were material and untrue,

[1] See also Bank of Tarboro *v.* Fid. & Dep. Co. of Md., 128 N. C. 366; 38 S. E. 908.

[2] Warren Dep. Bank *v.* Fid. & Dep. Co., 116 Ky. 38; 74 S. W. 1111.

[3] Shannon's Code, § 3306.

is a finding of fact conclusive on the Supreme Court on appeal.[1]

Again, under a statute declaring that no misrepresentation in an application should avoid a policy unless it was either made in bad faith or was material to the risk, it was held that an actual intent to mislead or deceive must have existed when the misrepresentation was made. If it was made in the honest belief that it was true, it was not made in bad faith, although the ignorance of the fact that it was not true was the result of the grossest carelessness.[2]

Where a fidelity bond provided that any wilful misstatement or suppression of facts by the insured in his statement or declaration concerning the employee should render the bond void from the beginning, it was held that the phrase "wilful misstatement" was intended to mean not merely a false statement, but one made with knowledge of its falsity, voluntarily and not inadvertently, and hence an instruction that the bond was not void unless the misstatements were made with intent to secure renewals of the bond was erroneous.[3]

Finally, attention is called to the principles so clearly stated in Ætna Insurance Company *v.* Simmons,[4] where the court touched upon the subjects of warranty and representation in general insurance law in the following language:

"(*a*) A warranty in insurance law is the assertion by the assured of some fact on the literal truth of which the validity of the policy depends, without regard to the materiality of such fact or the notice which prompted the assertion. (*b*) A representation in insurance law is also the assertion by the insured of some fact, but the validity of the policy does not depend upon the truth of the assertion. (*c*) The falsity of a representation is a defence to a suit on the policy only when made of a fact material to the risk and with a sinister motive. (*d*) Whether an assertion made by the insured of the existence of a

[1] First Nat. Bank of Nashville *v.* U. S. Fid. & Guar. Co., 110 Tenn. 10; 75 S. W. 1076.

[2] Penn. Mut. Life Ins. Co. *v.* Mech. Sav. Bank & Tr. Co., 73 Fed. Rep. 653; see also Trustees *v.* Fid. & Dep. Co., 76 O. St. 253; 81 N. E. 330.

[3] F. & C. Co. *v.* Bank of Timmonsville, 139 Fed. 101.

[4] 49 Neb. 811; 69 N. W. 125.

fact is a warranty or representation is a question of law. (*e*) Where an application is made a part of the policy, the two are to be construed together for the purpose of ascertaining whether the contracting parties intend that statements and assertions made by the insured should be regarded as warranties or representations. (*f*) If a doubt exists whether a statement made is a warranty or representation, it will be held a representation. (*g*) Warranties are not to be created or extended by construction. (*h*) In construing a contract for the purpose of determining whether the statements made therein were intended by the parties thereto to be warranties or representations, the court will take into consideration the situation of the parties, the subject-matter of the contract, the language employed, and will construe a statement to be a warranty only when it clearly appears that such was the intention of the parties; that the mind of each party conscientiously intended and consented that such should be the interpretation of his statements."[1]

§ 56. **What is the Doctrine of Misrepresentation in Fidelity Insurance?** — The "doctrine of misrepresentation" in its application to fidelity insurance may be stated as follows: All representations made by the insured to the insurer as an inducement to the issuing of a policy of fidelity insurance and not incorporated, either directly or by reference, into the policy as warranties, in order to avoid the policy must be material to the liability about to be assumed, and must be either wilfully false or else be made without the exercise of reasonable care in the premises. The essential features of the doctrine are first, that the representation must relate to facts which are material to the liability about to be assumed, and second, that it must be made in good faith and upon reasonable grounds for belief in the truth of the representation as made. The truth of the representations are not warranted; only the good faith of the party making them. Even bad faith in making the representations is no defence to an action on the policy, if such representations do not relate to matters

[1] See Trustees *v.* Fid. & Dep. Co., 76 O. St. 753; 81 N. E. 330; Globe Sav. & Loan Co. *v.* Emp. Lia. Assur. Corp., 13 Manitoba L. Rep. 531; Elgin Loan & Sav. Co., *et al.* *v.* London Guar. & Acc. Co., 11 Ont. L. Rep. 1906, p. 330; Hay *v.* Emp. Lia. Assur. Cor., 6 Ont. W. R. 459; U. S. Fid. & Guar. Co. *v.* E. S. S. & F. Co., 148 Fed. 353.

which are in contemplation of law material to the liability about to be assumed by the insurer. In any event substantial compliance with representations on the part of the insured is all that is required.[1]

§ 57. **The Power to make Representations.** — It was long supposed that the power to make representations as to the character of the "risk" and the scope of liability under a policy of fidelity insurance was among those implied ones common to all executive officers of corporate bodies. The bar generally was surprised at the position first taken by the United States Supreme Court on this particular question in the case of American Surety Company *v.* Pauly.[2] The subject itself is so important, and the decision to which reference is made is so wide-reaching in effect, that the facts as they arose in this case will be presented at some length. One Collins, who was the president of the California National Bank, made a proposal to the American Surety Company for a policy upon one O'Brien who was then in the bank's employ as its cashier. At the time this application was made, not only O'Brien, but Collins as well, were guilty of defalcations, and were even then acting together in a conspiracy to defraud the bank. O'Brien made his written application to the "surety company" for a policy, wherein he answered untruthfully certain material inquiries included therein. On this application Collins, as president (and knowing the falsity of the statements contained therein), indorsed thereon the following certificate:

"I have read the foregoing declarations and answers made by George N. O'Brien and believe them to be true. He has been in the employ of this bank during three years, and to the best of my knowledge has always performed his duties in a faithful and satisfactory manner. His accounts were last examined on the 28th day of March, 1891, and found correct in every respect. He is not to my knowledge, at present, in arrears or in default. I know nothing of his habits or antece-

[1] Fid. & Dep. Co. *v.* Guthrie Nat. Bank, 17 Okla. 397; 87 Pac. 300; First Nat. Bank of Nashville *v.* U. S. Fid. & Guar. Co., 110 Tenn. 10; 75 S. W. 1076.

[2] 170 U. S. 133; 42 L. E. 977.

dents affecting his title to general confidence or why the bond he applies for should not be granted to him."

O'Brien defaulted; and a claim under the policy was made on the "surety company" by the receiver for the amount of his defalcation. This claim was repudiated by the company on the ground, among others, that their liability under the policy had been discharged by reason of Collins's misrepresentations as contained in the foregoing certificate. During the trial of the suit which followed, the trial court denied a motion to direct a verdict for the defendant (the "surety company") on that ground. In making the motion the question was argued by and between the counsel for the receiver and those for the "surety company," whether the representations of Collins as president were binding upon the bank (or its representative, the receiver) in the suit then pending. It was contended with great earnestness that the act of Collins in making the representations was the lawful act of the corporation, and one which he had the clear implied power to perform. It was argued further that his own knowledge at the time that the representations were false did not make it any less the act of the bank; this under the well-established rule that any principal, however innocent, is responsible for his agent's fraud in a transaction on the principal's behalf and for his benefit. That no matter how the question may be presented, the rule is the same. If the principal is sued by the defrauded party, he cannot, while retaining the very benefit received by the agent's fraud, escape responsibility for this, however innocent he himself may be. That if, on the other hand, the principal be the plaintiff, and the defence rests upon the fraud of such agent, the former cannot undertake to enforce the contract without becoming responsible for all the instrumentalities by which it was obtained.

A contention directly opposed to the foregoing was made by the counsel for the receiver in opposition to the motion to direct a verdict in favor of the "surety company." It was

claimed that the bank was liable only for such acts of the president (Collins) as were within the scope of his authority, either express or implied. Even were this so, it was argued that, by reason of his criminal knowledge at the time, the bank was not bound by his representations; this last on the theory that the liability of an innocent principal for the frauds and deceits of its agent is restricted to those cases where the latter acts within the scope of his authority. Finally, it was contended broadly that the power to make such representations is in any event wholly beyond the power of a national bank. The trial court denied the motion for a directed verdict in favor of the "surety company," and the matter came up for review before the federal court of appeals,[1] and later before the United States Supreme Court. This last-named court, in disposing of this point, made use of the following language: [2]

"Without stopping to consider whether each of the above cases was correctly decided, it may be observed that those relating to sureties on bonds given to corporations arose directly between the sureties and corporations represented by their board of directors or by some of their officers acting within the authority conferred upon them; and that those relating to the liability of a principal, by reason of the acts or representations of his agent arose out of the agent's acts or declarations in the course of the business entrusted to him.

"None of the cases cited embrace the present one. In the first place, the procuring of a bond for O'Brien in order that he might become qualified to act as cashier, was not part of the business of the bank, nor within the scope of any duty imposed upon Collins as president of the bank. It was the business of O'Brien to obtain and present an acceptable bond. And it was for the bank, by its constituted authorities, to accept or reject the bond so presented. The bank did not authorize Collins to give, nor was it aware that he gave, nor was he entitled by virtue of his office, as president, to sign any certificate as to the efficiency, fidelity or integrity of O'Brien. No relations existed between the bank and the surety company until O'Brien presented to the former the bond in suit. What, therefore, Collins assumed in his capacity as president to certify as to O'Brien's fidelity

[1] 72 Fed. 470. [2] 170 U. S. 133.

or integrity was not in the course of the business of the bank nor within any authority he possessed. He could not create such authority by simply assuming to have it. The circuit court of appeals, speaking by Judge Lacome, well said that there were many acts which the president of a bank may do without express authority of the board of directors, in some cases because the usage of the particular bank impliedly authorized them; in other cases because such acts were fairly within the ordinary routine of his business as president; but that the making of a statement as to honesty and fidelity of an employee for the benefit of the employee, and to enable the latter to obtain a bond insuring his fidelity, was no part of the ordinary routine business of a bank president, and there was nothing to show that by any usage of this particular bank such functions were committed to its president. It must, therefore, be taken, as between the bank and the company, that the former cannot be deemed, merely by reason of Collins's relation to it, to have had constructive notice, that he, as president, gave the certificate in question.

"The presumption that the agent informed his principal of that which the duty and the interest of his principal required him to communicate does not arise where the agent acts or makes declarations not in execution of any duty which he owes to his principal nor within any authority possessed by him, but to subserve his own personal ends or to commit some fraud against his principal. In such cases the principal is not bound by the acts and declarations of the agent, unless it be proved that at the time he had actual notice of them, or having received notice of them, failed to disavow what was assumed to be said and done in his behalf. . . . Other citation of authorities would seem to be unnecessary to support the proposition that if Collins, the president, gave the certificate, that he might, with the aid of O'Brien, his cashier, carry out his purpose to defraud the bank for his own personal benefit, the law will not presume that he communicated to the bank what he had done in order to promote the scheme devised by him in hostility to its interests. In our judgment, the circuit court of appeals correctly held that plaintiff's right of action on the bond was not lost because its president, Collins, made to the defendant false representations as to the cashier's honesty. And that when two officers of a corporation have entered into a scheme to purloin its money for the benefit of one of them, in pursuance of which scheme it becomes necessary to make false representations to a third person ostensibly for the bank, but in reality to consummate such scheme and for the benefit of the conspirators, and not in the ordinary line of the routine business of such officers, without express authority,

the corporation being ignorant of the fraud, the officers are not, in thus consummating such theft, the agents of the corporation."[1]

As was pointed out in the first edition of this work, there is one part of the foregoing opinion which is little more than *dicta*, and should not be regarded as a final adjudication on the question immediately before us. In explanation of this statement it was pointed out that the nullification of the effect of the representations made by Collins, the president, resulted on other grounds than that of want of authority in the insured's officers to make the representations under which the insurer sought to escape liability. These were first and mainly on the ground that there was collusion between Collins and O'Brien (the "risk"), and secondly, that the representations complained of were not part of the policy and did not amount to warranties. This being so, the statement by the court, in its opinion, that it was no part of Collins's duty nor within his authority as president to sign any certificate as to the efficiency, fidelity or integrity of O'Brien, was unnecessary to a determination of the case. In fact, the record in the Pauly case showed that the policy itself did not refer to the statements of Collins complained of, nor did it appear that the bank itself provided the policy, nor was it affirmatively shown that the bank was aware of the representations made by the president.

The soundness of the criticism made in this connection upon the decision of the Supreme Court in American Surety Company *v.* Pauly was clearly demonstrated by the essentially different position taken by this same court in the later case of Fidelity and Deposit Company *v.* Courtney.[2] This same question was before the court in the case just referred to, and in deciding the question the court spoke as follows:

"The court erred in refusing to permit the defendant to read as evidence to the jury a letter of Edwin Warfield, president of the

[1] See also Sherman *v.* Harbin, 125 Ia. 175; 100 N. W. 629. Same case below, 103 Fed. 599; 43 C. C. A. 33.

[2] 186 U. S. 342; 46 L. E. 1193.

fendant, and dated May 15, 1896, and addressed to the German National Bank of Louisville, Kentucky, and also the reply of R. E. Reutlinger, the cashier of the said bank, written on May 29, 1893, addressed to the defendant, said letter having been an inquiry by the president of the defendant as to the renewal of the bond of McKnight, and the response being an assurance by the cashier of the bank that McKnight had up to that time performed his duties in an acceptable and satisfactory manner, and he, the cashier, knew of no reason why the bond should not be continued, — these letters, it being contended, were erroneously excluded on the ground that it had not appeared from the evidence that there was special authority from the board of directors to the cashier to write the letter of response of May 29, 1896. Further, the court also, it is asserted, erroneously refused to allow the defendant to prove by circumstantial evidence that the board of directors selected the bondsman of McKnight and paid for the bond and that the said cashier was acting in this matter with the knowledge and for the benefit and with the approval of the board of directors.

"We are constrained to the conclusion that error was committed in rejecting the evidence referred to in the foregoing connexion. It was competent for the defendant to show that the bank had concerned itself in and about the obtaining of the bond and renewals in such manner as to cause the transaction to become in effect the business of the bank. The bank had notice from the terms of the original bond that it was issued in reliance upon statements and representations made on its behalf to the surety company, and that, in the ordinary course, renewals, which were to be optional with the surety company, might also be based upon further statements to be made on behalf of the bank. Thus, in the original bond, it was recited that 'the said employer has delivered to the company a certain statement, it being agreed and understood that such statement constitutes an essential part of the contract hereinafter expressed.' It was a reasonable and proper precaution, in anticipation of a desired renewal, to propound the inquiries which were submitted by the surety company. The inquiry was obtained in a written communication, addressed to the bank; it was received by the bank, and it was proper to presume that it was delivered to the official who made reply thereto, by authority of the bank, he being the executive officer who was charged with conducting the correspondence of the bond. We think the making of the certificate was an act done in the course of the business of the bank. It did not purport to be, nor was it designed to be, the mere personal representation of the individual who filled the office of cashier,

but it was an official act, performed on behalf of the bank. The information solicited was such as was proper to be asked of and communicated by the bank, and as the renewal was presumably made upon the faith of the statements contained in the certificate, the bank ought not to be heard, while seeking to obtain the benefits of the stipulations agreed to be performed by the surety, to deny the authority of its officer to make the representations which induced the surety to again bind itself to be answerable for the faithful performance by McKnight of the duties of his employment. In Guarantee Company of North America *v.* Mechanics Savings Bank and Trust Company,[1] this court recognized as binding upon the bank a certificate given by one of its officers embodying replies to questions asked by the guarantee company respecting one of the employees of the bank although no proof was introduced that special authority had been conferred upon the officer to make the certificate. Nor does the ruling in American Surety Company *v.* Pauly [2] warrant the claim that it is an authority against the admissibility of the certificate here in question. In the bond considered in the Pauly case it was not agreed that the statement of the president, upon which the bond was obtained, should be the basis of the bond. The answers made by the person who was president of the bank in the interrogatories of the surety company were but mere commendations by one individual of another individual at the time when, as said by the court, 'no relations existed between the bank and the surety company.' Again, in the Pauly case no letter of inquiry was addressed to the bank, unlike the practice pursued with respect to the renewal here in controversy, and the letter, whose contents in the Pauly case was claimed to be binding on the bank, was written by one who was not charged with the duty of conducting the correspondence of the bank. As held in First National Bank *v.* Stewart,[3] a communication, which on its face evidences that it was written by the cashier of the bank, should not be excluded from the jury as not being an act of the bank where it 'appears with reasonable certainty to have regard to the business of the bank.' In the case at bar it is manifest these elements were present, and the exclusion of the certificate, as also of the evidence designed to establish that the giving of the certificate was an act done in the course of the business of the bank, was erroneous." [4]

[1] 183 U. S. 402; 22 Sup. Ct. Rep. 124.

[2] 170 U. S. 156; 42 L. E. 985; 18 Sup. Ct. Rep. 561.

[3] 114 U. S. 224; 29 L. E. 101; 5 Sup. Ct. Rep. 845.

[4] See to the same effect Elgin Loan & Sav. Co., *et al.* *v.* London Guar. & Acc. Co., 11 Ont. L. Rep. (1906), p. 330.

In this connection we wish to call attention to a principle which was clearly enunciated by the United States Supreme Court in the case of American Surety Company *v.* Pauly.[1] In this case it was claimed that a policy of fidelity insurance was avoided by reason of fraudulent misrepresentations, amounting under the terms of this policy to a breach of warranty on the part of one Collins acting as president of the insured. It further appeared that Collins, at the time he made the representations, was himself a defaulter, and acting in collusion with the one whose own previous conduct he was charged with misrepresenting. In passing upon the question the United States Supreme Court approved the charge of the trial court to the jury in the case, which was to the following effect:

"It is said that this bond of indemnity was obtained upon an application which was certified to by the bank [the insured] itself, and that in the application facts were concealed with fraudulent intent on the part of the bank, therefore, that the bond is void. The application was accompanied by a certificate of Collins, the president of the bank. The only knowledge of any facts which ought to have been communicated, or were misrepresented, the only knowledge which the bank possessed at the time that application was made, was the knowledge of Collins himself. Ordinarily a corporation, like any other principal, is chargeable with the knowledge of any facts which are known to its agents, but in this case all these transactions, if there were any transactions of a fraudulent and dishonest character on the part of the cashier, were transactions for the benefit of Collins, and he was a participator in the fraud, and under the circumstances the law does not infer that the agent or officer will communicate the fact to his principal, the corporation, and under such circumstances the corporation is not bound by his knowledge. So this defence melts away and there is nothing in it whatever."

After approving the foregoing charge the Supreme Court said:

"The presumption that the agent informed his principal of that which his duty and the interests of his principal required him to com-

[1] 170 U. S. 133.

municate does not arise where the agent acts or makes declarations not in execution of any duty that he owes to the principal, nor within any authority possessed by him, but to subserve simply his own personal ends or to commit some fraud against the principal. In such cases the principal is not bound by the acts or declarations of the agent, unless it be proved that he had at the time actual notice of them, and having received notice of them, failed to disavow what was assumed to be said and done in his behalf. . . . If Collins gave the certificate (as to O'Brien's past good conduct) that he might, with the aid of O'Brien as cashier, carry out his purpose to defraud the bank for his personal benefit, the law will not presume that he communicated to the bank what he had done in order to promote the scheme devised by him in hostility to its interests. In our judgment the circuit court of appeals [1] correctly held that plaintiff's right of action on the bond was not lost because its president, Collins, made to the defendant false representations as to the cashier's honesty; and that when two officers of a corporation have entered into a scheme to purloin its money for the benefit of one of them, in pursuance of which scheme it became necessary to make false representations to a third party, ostensibly for the bank, but in reality to consummate said scheme, and for the benefit of the conspirators and not in the line of the ordinary routine business of such officers and without express authority, the corporation being ignorant of the fraud, the officers are not, in thus consummating such theft, the agents of the corporation."[2]

Whether or not the case of the United States Fidelity and Guaranty Company *v.* Muir[2] can be distinguished from the ordinary cases covering the question of the authority of a principal to make representations be binding upon the corporation is not necessary to be determined here in view of the controlling decision of the United States Supreme Court in Fidelity and Deposit Company *v.* Courtney.[4] However, it should be noted that in that case the statements in the application were not referred to in the bond that was issued nor by its terms made part thereof. Neither had the president any special authority to make the representation as to the past conduct or condition of the "risk's" accounts and none

[1] 72 Fed. 484.

[2] See to the same effect Sherman *v.* Harbin, 125 Ia. 175; 100 N. W. 629.

[3] 115 Fed. 264.

[4] 186 U. S. 342.

of the directors knew of this statement until it was interposed as a defence by the insurer in a suit on the bond, defendant claiming that the statement was either a false warranty by the bank or a misrepresentation by it of material facts, which induced the defendant to execute the bond. It was held that making the statement was no part of the duty of the office of the president, and not within his implied powers or ordinary duties, and was in fact his individual act by which the bank was not bound. It may be stated as a broad general rule that where the insured seeks to avail itself of the benefit of the action of one of its executive officers in securing the execution of a bond guaranteeing the fidelity of a "risk," it must accept such action subject to such officer's representations inducing the execution of the contract by the insurer.[1]

Thus it has been well said that the insured, in accepting its president's action in procuring a bond guaranteeing the fidelity of its cashier, must be held to have assented to the conditions of the bond, providing that the representations made by the president relating to the duties and account of the cashier should constitute an essential part and form the basis of the contract.[2] In laying down the foregoing principle, the court spoke as follows:

"It is pleaded, and most earnestly argued on behalf of appellant, that the president had no inherent power by virtue of his office to represent the bank in this matter, and that it was no duty pertaining to his office either by powers conferred by the charter or by the by-laws of the bank, or its usage or custom, or by vote or resolution of its board of directors. That it claimed, on the contrary, that the board of directors alone had the power and authority under appellant's charter and under the law to represent the bank in the transaction of contracting a bond for its cashier and of making statements and representations to the surety on behalf of the bank regarding the same. While it may be true that, as a matter of law, answering questions such as these propounded to the president in this case and making representations therein contained, were not within either the actual or apparent scope of the duties of that office, and that the

[1] Warren Dep. Bank *v.* Fid. & Dep. Co., 116 Ky. 38; 74 S. W. 1111.

[2] *Idem.*

president was not authorized either by the charter or by anything appearing upon the minutes of the proceedings of the board of directors to make such representations on behalf of the bank, yet it does not follow from these premises that the president did not act in the bank's behalf in making them. There is no principle of law or agency truer or more familiar than that although an agent may act in fact without authority, expressed or implied, from his principal, his act may become binding upon the latter by its ratification."[1]

In a recent federal case where this matter was under consideration the facts were as follows: The board of directors of plaintiff corporation, whose meetings were held in New York, passed a resolution requiring the general manager and the assistant treasurer, both of whom were in the state of Washington, where the business of the company was conducted, to procure surety bonds, at the expense of the company, and they were so procured; that of the assistant treasurer being issued on a statement signed in the name of the company by the general manager as such, and which was referred to in the bond as having been furnished by the plaintiff, and as one of the inducements for the execution of the bond. At the expiration of the term requests for further statements or certificates from the employer were sent to the officers insured, which were filled out by the auditor of the company under its name and returned, on which renewal certificates were issued. The auditor's certificate that the account of the assistant treasurer had been examined each month and found correct, etc., was in fact untrue. The court held in an action against the "surety company" to recover for a defalcation of the assistant treasurer, that the auditor's certificate was properly admitted in evidence and the jury were correctly charged that if the fact of its execution was known to the general manager who was in charge of plaintiff's business, of which there was evidence, it was binding upon that officer, although the auditor may not have been authorized by virtue of his official position to make the same, plaintiff being charged

[1] Warren Dep. Bank *v.* Fid. & Dep. Co., 116 Ky. 38; 74 S. W. 1111.

with notice from the recitals therein that the original bond was issued upon a statement made in its behalf and bound to know what representations or renewals were made.[1]

What we regard as the true principle governing this whole question of the power of corporate officers to make representations in such manner and form as to bind the corporation, is set forth by the Supreme Court of Oklahoma in Willoughby *v.* Fidelity and Deposit Company of Maryland.[2] In this case it was claimed by the insured that even though it were true that wilful false statements had been made by one of its officers in the application for the policy made by the insured (a corporation) applying for a policy of fidelity insurance, nevertheless such statements were not binding on the insured for the reason that the officer who made them had no authority to make such statements or to bind the insured corporation in any way. The correctness of this claim was denied by the court in the following language:

> "This bond was issued by the defendant company [the insurer] and accepted by the bank [the insured] upon the faith of the correctness of the statements, and such statements were made warranties and became a part of the bond itself, and so becoming were a part of the contract sued on by the plaintiff. *It is well-settled law that a party seeking to recover upon a contract cannot claim the benefits arising therefrom and at the same time repudiate its burdens.* To allow the receiver of the bank, while suing on the contract, to question the authority of the assistant cashier to make statements and representations which are a part of the contract sued on, would be to allow him to accept its benefits and repudiate its burdens. To secure the bond on which the receiver sues, the bank, by its assistant cashier, made the representations which form a part of the bond itself, and it does not lie in the mouth of the receiver while suing on the bond to repudiate the statements and warranties made by the assistant cashier upon which the bond was secured."

§ 58. **Representations Classified.** — Representations may be classified as either affirmative or promissory.

[1] Issaquah Coal Co. *v.* U. S. Fidelity & Guar. Co., 126 Fed. 89.

[2] 16 Okla. 546; 85 Pac. 713; affirmed on appeal to the U. S. Sup. Ct. in 205 U. S. 537.

An affirmative representation has reference to those preliminary facts a knowledge of which is sought in order to enable the insurer to determine whether he will accept the application for a policy in any event, and if at all, at what premium. Again, affirmative representations refer exclusively to events either past or present, and if false at all, become so as soon as made.

Promissory representations, on the other hand, relate exclusively to the future, and in general point out a line of conduct which the prospective insured intends to pursue with reference to the business wherein the proposed "risk" is to be engaged. In some jurisdictions they are said to be the equivalent of a declaration of intention on the part of the insured of the line of conduct he expects to pursue in reference to the business wherein the "risk," whose honesty is to be insured, is to be employed.[1]

§ 59. **Affirmative Representations.** — In view of the fact that it is now the almost universal custom to make all representations warranties, by inserting a provision to that effect in the policy, comparatively few cases have arisen where representations as such have been considered and construed. However, the general rules of law in this connection are set out with some fulness by the United States Circuit court of appeals in the case of the Missouri, Kansas, and Texas Trust Company, *et al.* *v.* German National Bank.[2]

Here a policy of fidelity insurance was issued by a "surety company" to the German National Bank, wherein certain of the latter's employees were named as "risks." The policy was given to insure the bank for a period of twelve months against any loss that it might sustain in consequence of the fraud or dishonesty of said "risks" in the discharge of duty. Among these latter was one Goldman, its paying teller, who converted $14,000 of the bank's money to his own use. An action was brought to compel the insurer to make the loss good

[1] Benham *v.* U. S. Guar. & Ins. Co., L. R. 7 Ex. 744.
[2] 77 Fed. 117; 23 C. C. A. 65.

according to the provisions of the policy. The insurer relied for its defence to the suit upon a plea that it had been induced to assume liability, so far as Goldman was concerned, upon material false representations made by said Goldman and by the cashier of the insured bank. It alleged in substance that before assuming the liability in question Goldman made an application to the "surety company" to induce the issuance of a policy. That attached to said application (the same being on a printed form furnished by the insurer) was an "employer's declaration," which was signed by Charles M. Clinton, cashier of the insured bank. Clinton therein declared that he had read the declaration and answers made by said Goldman contained in said application, and that to the best of his knowledge the answers made were true; that Goldman was not to his knowledge in arrears or in default. It further appeared that in said application Goldman was asked the following questions, and answered them as follows:

"*Q.* Are you engaged in purely speculative transactions, such as stocks, grain, oil or real estate?

"*A.* Have bought and sold real estate.

"*Q.* Do you owe your employer anything on account whatever? If so, state how much, on what account and when due.

"*A.* Note; $4000, due December 2, 1890.

"*Q.* Give particulars and amount of any debt you owe or liability you are under.

"*A.* Yes; $2000, on real estate."

It was claimed by the insurer that Goldman's answer touching the amount of his indebtedness to the insured bank was false and fraudulent in that he owed said bank $7700 in place of $4000 as stated; and, further, that the declaration made by Charles M. Clinton, as cashier, to the effect that Goldman was not in arrears or in default to the bank, was false and misleading in this, that at the time such statement was made he well knew that said Goldman was in arrears, and owed the bank a large sum in excess of $4000.

The insured, in reply to this defence, averred in substance,

that after the insurer became aware that Goldman was indebted to the bank in the sum of $7700 and to other persons in the sum of $5000 and that the aforesaid statements contained in Goldman's application and in the "employer's declaration" were untrue, it had caused certain deeds of real estate to be executed by Goldman's relatives, to secure it against loss by reason of having executed the aforesaid bond; that it had also brought an attachment suit against Goldman in the sum of $10,000; that by such acts it had recognized its obligation on the bond, and had thereby waived whatever defence it might otherwise have urged against a suit to enforce the liability incurred and assumed. The trial resulted in a verdict and judgment against the "surety company" in the sum of $10,000.

One of the questions considered on the appeal was whether the trial court erred in permitting the jury to determine whether Goldman's answer touching the amount of his indebtedness to the bank was substantially true. With reference to that subject the charge of the court below had been as follows:

"We assume, for the purpose of inquiry, that the answer was false, to the knowledge of the bank, that is, to the knowledge of the corporation; and the question upon that is whether this answer is one which was likely to, and did, mislead the insurance company to its prejudice — that is to say, whether, this answer being false to the extent of about $3700 or $3800, the insurance company was induced to enter into this contract when it would not have done so if the answer had been truthful in respect to these matters. That is regarded as a question of fact which you must decide upon the testimony, — what, in your observation and your judgment as business men, would be the case, if the answer had been truthfully made that the man Goldman was indebted to the bank in the sum of between $3700 and $3800 more than the amount of $4000 which was specified in the answer of Goldman? If, upon that, you say that the company would not have made this contract as to Goldman if they had known of this circumstance, then the company may avoid the contract upon that ground subject to what I shall say to you presently upon the subject of waiver."

Commenting on the above the court of appeals observed:

"It is obvious, we think, that the statement made by Goldman concerning the amount of his indebtedness to the bank was not a warranty. In suits founded upon insurance policies which are in all respects analogous to the case at bar, it is held universally that statements made by the insured, to constitute warranties, must enter into and form a part of the contract itself; and where they are contained in the application, they are always construed as representations, unless by the express provisions of the policy the application is made a part thereof, and the intent is manifest to give them the effect of warranties. Besides, as warranties must be literally fulfilled, the courts have always manifested a strong indisposition to regard any statement made by the insured as a warranty unless such was the obvious purpose of the parties to the contract.

"In the present case it appears that the statement made by Goldman touching the amount of his indebtedness to his employer is found in the application only. No reference whatever was made to the application in the bond. It does not recite that it was issued in pursuance of a written application made therefor, or on the faith of the representations or statements therein contained. It is obvious, therefore, that within the rule above stated the statement in question must be treated as a representation rather than a warranty. Counsel for the trust company insist, however, that even if the statement be regarded as a representation, it nevertheless related to a subject concerning which the trust company, in its printed form of application, had seen fit to make special inquiry, and that it was therefore material representation, and that the court erred in permitting the jury to determine whether it was material or otherwise. This contention, we think, rests upon a misconception of the meaning of that paragraph of the charge which is above quoted. The trial court did not allow the jury to determine whether the representation related to a material matter. It held, as a matter of law, that the representation was material, but directed the jury to ascertain whether it was so far false and misleading as to render it substantially untrue. The trial court instructed the jury, in substance, that the representation would serve to avoid the bond, if they were satisfied that the trust company would not have assumed the risk, so far as Goldman was concerned, had it known the true amount of his indebtedness to the bank. This direction, we think, was right. If a representation relating to a material matter is substantially true, that is to say, if it is so far true that the conduct of the insurer would not have been different if it had known the exact truth, it will not vitiate the policy; and whether it

was substantially true or substantially false is a question for the jury. It does not appear to be claimed that the statement contained in the 'employer's' declaration which was signed by the cashier was wilfully false and misleading. The cashier, it seems, signed the declaration in haste, without looking at the books to ascertain the amount of Goldman's indebtedness, believing at the time that Goldman had truthfully answered all the questions propounded to him, and without any intent to deceive or mislead the trust company as to the extent of such indebtedness. Under these circumstances we think that the portion of the charge above quoted stated the law with substantial accuracy, and that the trust company has no just ground for complaint." [1]

Again, attention is called to the case of Pacific Fire Insurance Company *v.* Pacific Surety Company.[2] In this case the California agent of a New York insurance company was bonded under a contract requiring him to remit payments within fifty days from the end of the month in which they are payable. He failed, through tardiness and neglect, but with no wrongful intent, to remit premiums until from sixty to one hundred and twenty days after the end of such month, and this action was acquiesced in by the company as a substantial compliance with the contract. The contract between the company and the agent further required the latter to remit the premiums of each month on or before the 20th of the second month afterwards. A certificate was made by the insured to the insurer one day after the premiums became due and unpaid, stating that the agent was not in arrears.

Also certificates were furnished by the insured to the insurer, averring that the agent had never been in arrears, when the payment of premiums was sometimes delayed for two or three months, although such payment was accepted by the insured as a substantial compliance with the contract. It was held by the court that neither of said certificates was fraudulent, and did not have the effect of relieving the insurer from liability by reason of any of the statements therein contained.

It has been held that a representation that the "risk"

[1] See Harris *v.* Remmell, Ark. ; 102 S. W. 716.
[2] 28 Pac. 842; 93 Cal. 7.

has never been in default is not restricted to the latter's employment by the insured, but applies so far as the latter's knowledge extends to third parties as well.[1] Again, in Supreme Council, etc. *v.* Fidelity and Casualty Company of New York[2] it was said that loose parol statements by the insured prior to the issuance of the policy, even if amounting to misrepresentation, did not affect the contract subsequently entered into. The doctrine of the English courts is well represented by the case of Byrne *v.* Muzio.[3] Here the court held that where it is desired to offer evidence showing that the guaranty of the fidelity of a rate collector was entered into by the guarantor in reliance on the statement and representation made by the party guaranteed and the person employed, to the effect that the latter had no balance outstanding at the time the guaranty was given, nor irregularity in his account, it is not sufficient to allege that such representations were untrue. The pleading must go farther, and either allege that the statement was fraudulent, or allege circumstances from which fraud can be inferred as a matter of law. If the word "fraudulently" be omitted, there must be an allegation of fact which necessarily and *per se* amounts to fraud.

Where an employer, in making a certificate to the "surety company" on the giving of a bond by an employee, stated that the employee was trustworthy *to the best of his knowledge*, the fact that the employee had previously misappropriated funds did not serve to relieve the surety company of liability in the absence of any showing that the employer had any knowledge or suspicion at that time that the employee was not honest and reliable.[4]

Where the certificate of a president of a building association to a "surety company," stating that the accounts of an employee were correct in every respect, did not purport to be a statement of other matters and was stated only to the best of his

[1] Ottawa Agri. Ins. Co. *v.* Can. Guar. Co., 30 U. C. C. P. 360.

[2] 63 Fed. 48; 11 C. C. A. 96.

[3] L. R. 8 Ir. C. L. 396.

[4] Hawley *v.* U. S. Fid. & Guar. Co., 90 N. Y. Sup. 893; 100 App. Div. 12.

knowledge and belief, the fact that at the time the auditing committee of the association knew that a mistake existed therein did not relieve the "surety company" from liability on the bond.[1]

On an issue whether the president of a building and loan association has made false representations to a "surety company" as to the business integrity of an employee, the question whether at the time of such statement he knew that the employee had failed to make a semi-annual report was properly excluded where there was no evidence that it was the employee's duty to make the report.[2]

We now come to a line of cases which repudiate the theory that "good faith" is all that is necessary under all circumstances in the case of representations made by the insured to the insurer, and hold that the good faith must be accompanied by evidence showing either that the representations made by him were true, or that the insured had reasonable ground for believing that they were true. These cases, to our minds, present the law as it should be, and are not open to the criticism of making the possession of good faith cover all the sins of the insured, however committed. Attention is now invited to the cases here referred to.

In an action on a fidelity bond defendant, on the ground that plaintiff in a statement required of him prior to the issuance of the bond, asserted that, to the best of his knowledge and belief, the employee's accounts were correct, and that he was not in arrears, when by due care in examining such accounts a shortage could have been discovered, an instruction to find for plaintiff, unless the statement was false, when made to the best of plaintiff's knowledge and belief was erroneous, since defendant was entitled to go to the jury on the issue of plaintiff's due care, to ascertain the truth before making the statement.[3]

[1] Perpetual Bldg. & Loan Ass. *v.* U. S. Fid. & Guar. Co., 118 Ia. 729; 92 N. W. 686.

[2] *Idem.*

[3] U. S. Fid. & Guar. Co. *v.* Blakely Hurst & Co., 117 Ky. 127; 77 S. W. 709.

"There is no principle of law better settled than that persons proposing to become sureties to a corporation for the good conduct and fidelity of an officer to whose custody its moneys, notes, bills and other valuables are entrusted, have the right to be treated with perfect good faith. If the directors are aware of secret facts materially affecting or increasing the obligations of the sureties, the latter are entitled to have these facts disclosed to them, the proper proof being presented.[1]

"The law requires of an employer who makes representations material to the 'risk' for the purpose of inducing another to become bound as the surety of one of his employees to him more than the mere belief on his part of the truth of such representations. His duty under such circumstances requires that before making such representations he should use ordinary care to know that they are true."[2]

The Kentucky statute,[3] providing that all statements or descriptions in any application or policy of insurance shall be deemed representations and not warranties, nor shall any representation, unless material or fraudulent, prevent a recovery on the policy, has been held to apply to contracts guaranteeing the honesty of employees as well as to life and fire policies. Under said statute a bond and application providing that any material misstatement or suppression of fact by the employer in any statement or declaration to the company, or in any claim made under the bond, should render the same void from the beginning and that it should also be void if the employee had within the knowledge of the employer been a defaulter at any time during his service, etc., and a statement accompanying the application to the effect that such employee had given satisfaction in his personal conduct, faithfully performing his duties and kept and rendered his accounts correctly and without default, while requiring the applicant to not only state what he believed, but to answer and take reasonable precautions and use ordinary care to

[1] U. S. Fid. & Guar. Co. *v.* Blakely Hurst & Co., 117 Ky. 127; 77 S. W. 709.

[2] *Idem.* First Nat. Bank *v.* U. S. Fid. & Guar. Co., 110 Tenn. 10; 75 S. W. 1076.

[3] 1903, § 639.

acquaint himself with the facts respecting his employee's honesty, did not require that statements so made should be absolutely true, the term "misrepresentation" having reference to misstatements known to be untrue and positively stated to be true without actual knowledge by the insured, or made under circumstances calling for such knowledge as might be based on reasonable care previously exercised.[1]

In this same case it was held that where a bank in order to acquire knowledge on which to base its statements as to the honesty of an employee employs an expert accountant to examine such employee's accounts, on whose examination and report it bases such statements, it is not chargeable with such examiner's negligence. In such a case the bank was chargeable only with the exercise of ordinary care in selecting competent examiners to investigate the employee's accounts.[2]

A fraud may be perpetrated as well by the assertion of facts that do not exist, ignorantly made by one whom a person acting upon the assertion has the right to suppose used reasonable diligence to inform himself as by concealing facts known to exist in equity and good conscience ought to have made.[3]

If the proposed surety in a bond for the conduct of an employee makes inquiry of the proposed obligee, as to the previous conduct of the employee, such obligee is bound to make full disclosure of all material facts within his knowledge bearing on the "risk," and if he fails to do so, or knowingly makes, in response to the inquiry, false representations as to such facts, or does so ignorantly, but under such circumstances as would naturally lead the inquirer to believe the representations to be based on an investigation, and the proposed surety is thereby induced to sign the bond, he may avoid liability

[1] Fid. & Guar. Co. of N. Y. *v.* Western Bank, 29 Ky. L. Rep. 639; 94 S. W. 2.

[2] Fid. & Guar. Co. *v.* Western Bank, 29 Ky. L. Rep. 639; 92 S. W. 2.

[3] First Nat. Bank *v.* U. S. Fid. & Guar. Co., 110 Tenn. 10; 75 S. W. 1076.

thereon on the ground of fraud. But an innocent false representation in such a case, such as the assertion of a mere opinion or the misstatement of a fact, through mere ordinary negligence, not made under such circumstances as to suggest that it was based on an investigation, will not relieve the surety of liability.[1]

The cases where the subject has been dealt with are generally to the effect, that when a person at the time of obtaining the signature of the surety knows facts affecting the "risk," and knows or has reasonable ground to believe the latter is ignorant thereof, upon inquiry by the latter of the former he is bound to make a full disclosure. In the words of the Wisconsin Supreme Court:

". . . If false representations are ignorantly made to a proposed surety by the proposed obligee, respecting the material facts bearing on the proposed 'risk' under such circumstances that such proposed surety has reasonable ground to believe that they would not be made except from conviction of the truth resulting from diligent investigation, the result is the same as if the obligee has actual knowledge.

"We recognize that there are authorities which, *arguendo* at least, go farther than above indicated, but the better rule, it seems, and the weight of authority, is that something more than mere innocent misrepresentation — misrepresentation through ordinary negligence or the expression of an opinion — is necessary to constitute fraud equivalent to actual fraud so as to discharge a surety.

"It may be stated as a rule that upon the proposed obligee in a surety bond being applied to for information by the proposed surety as to the previous conduct of the proposed principal obligor, it is his duty to make full disclosure of all material facts within his knowledge bearing on the 'risk,' and if he fails to do so, or knowingly makes in response to the inquiry false representations as to such facts, or ignorantly does so, but under such circumstances as would undoubtedly lead the inquirer to believe the representations to be based on an investigation (as, for instance, representations by a director of a bank charged with the duty of investigating the accounts of its cashier), and the proposed surety is induced thereby to sign the bond, he may

[1] First Nat. Bank *v.* U. S. Fid. & Guar. Co., 110 Tenn. 10; 75 S. W. 1076; Brillon Lumber Co. *v.* Barnard, 131 Wis. 284; 111 N. W. 483.

avoid liability thereon on the ground of fraud, yet an innocent false representation under the circumstances stated, which is the assertion of a mere opinion or the existence of a fact not derived from investigation or made under such circumstances as to suggest such derivation, but entertained and made through mere ordinary negligence, is immaterial." [1]

§ 60. **Promissory Representations — Declaration of Intention.** — A representation, instead of being a statement of fact, not infrequently embodies merely the expectation, intention and belief of the insured, that certain future events relative to the prospective "risk" shall or shall not take place. In such a case, even though the representations be material to the "risk," if the statements do not embody a warranty, and clearly are intended to represent merely an expectation or belief that certain facts will exist or will happen in a certain way, the insurer is not bound to rely upon such belief or expectation of the insured, but is obligated to make further inquiry before relying thereon.

The rule under the circumstances above referred to seems to be that these so-called promissory representations are to be treated as mere declarations of an unexecuted intention, and that a failure to comply with such declaration is not fatal to a recovery upon a contract induced by it.[2]

This subject was discussed at some length in Benham *v.* The United Guaranty and Life Assurance Company.[3] Here the defendants granted to the plaintiff, the treasurer of a literary institution, a policy of guaranty against loss occasioned by the want of integrity of W., the secretary of the institution. The policy recited that, as the basis of the contract for such guaranty, the plaintiff had lodged at the

[1] See Brillon Lumber Co. *v.* Barnard, 131 Wis. 284; 111 N. W. 483; see also *ante*, § 55.

[2] Rice *v.* Fid. & Dep. Co., 103 Fed. 427; 43 C. C. A. 270; Towle *v.* Nat. Guar. L. Ins. Co., 7 Jur. N. S. 1109; Benham *v.* Guar. & L. Ins. Co., L. R. 7 Ex. 744; Regina *v.* Nat. Ins. Co., 13 Vic. L. R. 914; Atty. Gen. *v.* Ad. L. Assur. Guar. Co., 22 South Aus. L. R. 5; Hay *v.* Emp. Lia. Assur. Corp., 6 Ont. L. R. 459; Elgin Loan & Sav. Co., *et al. v.* London Guar. & Acc. Co., 11 Ont. L. Rep. (1906) 330.

[3] L. R. 7 Ex. 744.

office of the defendants a certain statement in writing, containing a declaration signed by the plaintiff, of the truth of the answers thereby given to the questions therein contained. This statement contained among others the following questions and answers:

"1st. Is the applicant at present in your employment, and, if so, in what capacity; and has he hitherto performed the duties of his situation faithfully and to your satisfaction? — He is secretary of the Marylebone Literary Institution.

"2d. Is the applicant personally known to you or any of your firm; or by whom has he been introduced or recommended to you? — Only as above.

"3d. In what capacity do you intend to employ the applicant? And, with reference to this question, state, as far as circumstances will permit (*A*) the nature of his intended duties and responsibilities. (*A*) He is secretary of the Marylebone Literary Institution, of which I am treasurer. (*C*) The checks, which will be used to secure accuracy in his accounts, and when and how often they will be balanced and closed. (*C*) Examined by finance committee every fortnight. (*D*) The salary, or emolument, and when it will be paid to him, and how and when it will be paid. (*D*) Eighty pounds a year at present."

It was held that the statement that the accounts would be examined by the finance committee every fortnight did not amount to a warranty, but was a mere representation of the intention of the plaintiff; and, consequently, that he was entitled to recover in respect to a loss arising from the want of integrity of W., although such loss was occasioned by the neglect to examine the accounts in the manner specified.

Again, in this same connection, attention is called to the case of Towle *v.* National Guardian Assurance Society.[1] Here, according to the terms of a proposal by a tax collector, A., for a guaranty policy, answers were required by the guaranty society not only from the applicant, but also from his intended employers. Those employers were the commissioners of taxes, who, in reply to inquiries from the society, accepted the answer of the overseer of taxes, who, in reply to inquiries from the society, stated that the collector's accounts would

[1] 7 Jur. N. S. 1109.

be checked weekly, and that he would not be allowed at any time to hold in his hands more than from £100 to £200. A. absconded while in default to the amount of £654, and it appeared in evidence that although it had been the practice prior to A.'s appointment to check weekly the accounts of the collector who preceded him, such practice was not continued after his appointment. Upon a bill by A.'s sureties for the purpose of obtaining payment of the money assured by the policy, it was contended that the statement of the overseer of taxes did not amount to a warranty, inasmuch as it was a representation by a third person who was not a party to the contract, as to the course intended to be pursued by another person; secondly, that the representation in question being not to a past or existing state of things, but to the future acts of other persons, had no application to the case of a guaranty policy, and as the representation was made fairly and honestly and was substantially correct, it did not vitiate the policy. But it further appeared that the terms on which the guaranty policy was effected made it compulsory on A. to effect a life policy with the above society, and he accordingly did so. On the life policy a memorandum was indorsed, stating its connection with the guaranty policy. The society transferred their business to a life assurance company, which received the premiums on the guaranty policy, and A. also paid the premiums on the guaranty policy to an agent of the latter company. It was held, upon appeal to the Lords Justices, that the policy was void from the beginning, as being founded on misrepresentations amounting in law to a warranty, and on this and on other grounds the bill was dismissed.[1]

A most instructive case upon the general subject of promissory representations is that of Champion Ice and Cold Storage Company *v.* American Bonding and Trust Company.[2] It

[1] See also Regina *v.* Nat. Ins. Co., 13 Vic. L. Rep. 914; Atty. Gen. *v.* Adelaide L. Assur. Guar. Co., 22 South Aus. L. Rep. 5.

[2] 115 Ky. 863; 75 S. W. 197.

was there held that where a policy was issued insuring the insured against any fraudulent conduct of a designated "risk" amounting to larceny or embezzlement in the latter's position as bookkeeper, but in no other position to which he might be called, representations made by the insured in the application for the policy that the largest amount of money likely to be in the "risk's" hands would be but a few dollars, could not be considered fraudulent or material, but were to be regarded as merely promissory representations. This holding was made in the light of a state statute providing that all statements or descriptions in an application for an insurance policy should be deemed representations and not warranties. The court in its opinion spoke as follows:

"Now in the light of this statute and that of the well-known rule of elementary law that contracts of insurance are to be construed more favorably to the insured than the insurer, the answers contained in the application are not warranties, and by the terms of the bond itself it is apparent that they were neither fraudulent nor material. There is no averment in the answer that the bond of indemnity would not have been executed if the answers contained in the application had shown that Weitkamp would have been permitted to draw money from the bank on checks for the weekly payroll, nor does the answer allege that appellee was in any way misled or deceived by appellant's answers to these written questions. They were indeed mere promissory representations, to be treated as actual declarations of an intention, and the failure to comply with such declarations is not fatal to a recovery upon a contract not induced by it."

"There can be no question but that the covenants of the bond covered such a loss as was sustained by the appellant. Its one purpose was to insure against loss that might result to appellant from the fraud or dishonesty of Weitkamp (the 'risk') amounting to larceny or embezzlement, whether the loss was that of money, securities or other personal property belonging to the appellant or for which it might be made responsible; and the indemnity thus offered by the bond not only applies to any fraud or dishonesty which Weitkamp might have committed in the performance of his duties as bookkeeper, but also to such as he may have committed in any other position in appellant's employment to which he may have been appointed or called upon to fill. It is not material, therefore, whether the fraudu-

lent or dishonest acts of Weitkamp which caused loss to appellant were committed by the making of false entries in its books, by the raising of its checks or by abstracting money from its money-drawer, nor is it material whether he was at the time acting as bookkeeper or in some other capacity in appellant's service. Under either or under any of this evidence, appellee under the terms of the bond would be and is liable for the loss which he occasioned."

A case not wholly in accord with the foregoing is that of Elgin Loan and Savings Company, *et al. v.* London Guarantee and Accident Company.[1] In this case the court held that the statement as to checks being audited, as stated in the insured's proposal, in the case of a " risk " already in its service, should be regarded not as statements of intention, but as representations of an existing course of business embracing both past and future, which, if materially untrue, should be held to vitiate the contract. " Any other conclusion," observed the court, " would be manifestly unjust to the insurer, who is not in a position to otherwise ascertain the facts so obviously material to be found by him in order to estimate the risk to be undertaken. And it is or ought not to be any hardship upon the insured to hold him steadfastly to the statement so made, which from the circumstances he must have known would form the basis of the contract of insurance.[2]

"Probably the two cases which have been here referred to may be distinguished by noting that in the former case there was a statute bearing on the matter, while in the latter case the fact that the ' risk ' was already in the employ of the insured might well have been a controlling element in inducing the court to arrive at the conclusion it did.

"But when we come to the course indicated as that to be followed by the company, it seems to be but an inadequate protection of the surety if the court holds that the proposal indicated merely the intentions of the company and its officers at the time of making the proposal. Whether we are or are

[1] 11 O. L. Rep. (1906), p. 330.

[2] To the same effect see Globe Sav. & Loan Co. *v.* Emp. Lia. Assur. Corp., 13 Manitoba Rep. 531; Hay *v.* Emp. Lia. Assur. Corp., 6 Ont. L. R. 459.

not to construe the incorporation of the proposal in the policy as constituting a warranty by the company, that it will adhere to the course indicated by the answers, it appears to me that upon principles of equity the surety should be considered as discharged by a departure from that course materially contributing to a loss insured against. Such a case would seem to come within the principles of Lawrence *v.* Walmesley.[1] But failure to use the checks and safeguards set out as intended to be used would seem as injurious as parting with a more definite security. I am strengthened in this opinion by the view which Lord Justice Knight Bruce took of Towle *v.* National, etc. Society."

CHAPTER IX

(IV) DISCHARGE OF LIABILITY BY CONCEALMENT

§ 61. **Concealment defined and discussed.** — Concealment, as that term is here used, has reference solely to a failure on the part of the insured, either while negotiations are pending for the issuance of a policy or during the life thereof, to disclose facts known to him material to the contract about to be entered into, and reasonably calculated to influence the insurer's judgment as to whether the liability shall be assumed or continued, and if so, at what premium. It is the suppression of the truth by a withholding of facts concerning which no questions are asked by the insurer of the insured. It is the *suppressio veri,* so often referred to in the books and reports appearing in a new form in the domain of insurance law.

In gratuitous suretyship the rule is unquestioned that contracts of that character require entire candor, and if the truth is so stated as to mislead, the surety will be discharged.

The doctrine of concealment in its relation to fidelity insurance must of necessity be viewed from two distinct standpoints.

[1] 12 C. B. N. S. 799.

First, in respect to the effect of concealment when there is no contract obligation requiring the insured to communicate all material facts to the insured either before or after the assumption of liability under the policy. Secondly, the subject must be discussed with reference to those provisions of the policy which customarily provide that any wilful suppression of any fact affecting the liability of the insurer, either prospective or present, shall render the policy void from the beginning. Looked at from the first standpoint above referred to, concealment is but little else than an extended application in the law of fidelity insurance of the equitable doctrines relative to fraud. In its second aspect, as stated above, it is to be treated rather as a condition precedent to the maintenance of continued liability under a policy, that the insured shall not have been guilty of any wilful or intentional fraud with respect to concealment of facts affecting the liability of the insurer.

The remarks of the court in American Credit Indemnity Company *v.* Wimpfheimer,[1] while uttered in connection with a consideration of a policy of credit insurance, are equally applicable here. In that case it was said that "*suppressio veri*, or concealment, will amount to fraud where the concealment is of material facts, where there is such a relation of trust and confidence between the parties that the one party is under some legal or equitable duty to give full information to the other, and which the latter has a right, *juris et de jure*, to know, and then the withholding of such information purposely may be a fraud. Where the parties deal at arm's-length, on equal terms, and no particular relation of trust or confidence exists between them, there is usually no obligation to speak; either may remain silent and be safe. Contracts of life and marine insurance stand on somewhat different grounds from other contracts. Although one may have the right to be silent under ordinary circumstances, there are many cases in which the very proposition of a party implies that certain things, if not told, do not exist. This is peculiarly

[1] 14 N. Y. App. Div. 498; 43 N. Y. Sup. 909.

the case in contracts of insurance where the insured is bound to state all facts within his knowledge which would have influence upon the terms of the contract, and are not known, or may be supposed by him not to be known, to the insurer. In these cases, and in others which come within this principle, the *suppressio veri* has the same effect in law as the *expressio falsi*. But this rule is peculiar to such policies. I find no authority for extending it to all other contracts, and there is authority to the contrary; the rule which prevails in assurance upon ships and lives, that all material circumstances known to the assured must be disclosed, though there be no fraud in the concealment, does not extend to the case of guaranties. In the latter case, the concealment, to vitiate the guaranty, must be fraudulent. We think it is going too far to say that the insured is in all cases, and without being inquired of, bound to communicate everything that it is important for the insurer to know and that would increase the risk. Under such a rule no one would know when he could rely on a bond, and it would lead to a good deal of litigation." [1]

Attention has already been called to the fact that the subject-matter of concealment in fidelity insurance permits of a twofold division for purposes of discussion, one having reference to concealment on the part of the insured both before and after the policy is entered into, when under no contractual obligation to make any disclosures, and the other relating to the duty of the insured when he has bound himself by apt words inserted in the policy to make disclosures to the insurer of the nature described therein. The first of these will now be considered under the head of the "spontaneous disclosure doctrine," while the second belongs properly to the subject-matter of "conditions" and will be reserved for subsequent discussion under that head.[2]

§ 62. **The "Spontaneous Disclosure Doctrine."** — Long be-

[1] See Guar. Co. of N. A. *v.* Mech. Sav. Bank & Tr. Co., 80 Fed. 766; 26 C. C. A. 146; see also Bank of Tarboro *v.* Fid. & Dep. Co., 128 N. C. 366; 38 S. E. 908.

[2] See *post*, § 100.

fore fidelity insurance itself was known there had been enunciated by the courts a rule of conduct particularly applicable to obligees in private surety bonds. This was then, and still is, known as the "doctrine of spontaneous disclosure." The doctrine, being freely interpreted, may be stated thus: That an obligee in a bond must at his peril tell the obligor (the surety) everything he knows with reference to the proposed liability, whether the same is in his judgment material or not. This, too, whether the non-disclosure was fraudulent or not. The foregoing doctrine seems to have had its origin in a dictum of Lord Truro's in Owen *v.* Homan,[1] and has been followed in a respectable number of cases.

However, notwithstanding this fact, it cannot be said at this time that the doctrine of spontaneous disclosure, even in contracts of private suretyship, has been given the broad scope outlined by Lord Truro. The modern rule seems to be, even in the case of private sureties, that the obligee is under no obligation other than that of the exercise of perfect good faith towards his obligor.

The cardinal rule of duty which the obligee in a private indemnity bond owes to the obligor therein is entire good faith. If he discovers acts of dishonesty on the part of the "risk," and retains him in his service without notice to the surety, he is guilty of such fraud and bad faith towards the latter as will discharge the former from liability. Mere negligence on the part of the obligee in failing to discover the defaults of the employed will not release the surety. It does not in any case apply to mere breaches of duty or of contract obligations on the part of the employed, not involving dishonesty on his part or fraudulent concealment on the part of the insured. The concealment of fraud or dishonesty on the part of the employed which will avoid a bond has reference not only to the latter's employment by the obligee therein, but it applies as well to all prior employments.

All the cases proceed on the theory that the ordinary surety

[1] 3 Mac. & G. 378.

is not compensated, and usually has no voice in the contract, and makes no limitations upon the extent of his liability. He signs a bond and leaves it to law to determine the extent of his obligations, and to limit or qualify them accordingly. On the other hand, a fidelity insurance company as a compensated surety prepares the contract; in its every detail determines for itself what it desires or cares to know; puts searching questions to this end; makes provisos and conditions as to its ultimate liability. It leaves nothing to the law except such fraud as may be practised upon it. Therefore it may, perhaps, be argued that the law will presume that it has indicated the immateriality of all matters not communicated, by not asking any questions in regard to them of the insured. Reference is had here, of course, to concealment occurring prior to the issuing of the bond. As to concealment occurring thereafter, and not amounting to fraud or bad faith on the part of the insured, it might here again be argued that if the insurer desired such facts to be communicated, it should have made provision for the same in the policy. The question then presents itself, To what extent, if at all, is the foregoing argument sound? The "doctrine of spontaneous disclosure" had its inception largely in a recognition of the principle that sureties are favorites of the law. The courts have very generally expressly refused to extend this principle to contracts of fidelity insurance. Assuming for the purpose of the argument that this ruling is sound, it might be argued with no little force that the doctrine of spontaneous disclosure, being in effect an extended application of a principle not recognized in the law of fidelity insurance, has no proper place therein. Few of the courts, so far as investigation shows, have either fully adopted or repudiated the ancient doctrine of spontaneous disclosure in construing fidelity insurance contracts.

The earlier English doctrine on this subject (since repudiated) is clearly set forth by the case of Seaton *v.* Heath.[1] This was an action wherein a guaranty insurance company

[1] 1 L. R. App. Cas. for 1899, 782.

had for a consideration given a guaranty running to the payee of a promissory note to the effect that the guarantor of such note should be solvent in respect to, and to the extent of, £15,000 sterling. The policy provided that no claim should attach thereto until the said guarantor should have a receiving order in bankruptcy made against him, or should call a meeting of his creditors, or, in the event of the decease of said guarantor before the payment of said promissory note, his estate be insolvent.

The defence set up was that the doctrine was a policy of insurance, and that there had been misrepresentations of fact, and a concealment of material facts by the plaintiff (the payee of the note), by which the defendant had been induced to execute the policy. In passing upon the foregoing issues the court spoke as follows:

"There are some contracts in which our courts of law and equity require what is called *uberrima fides* to be shown by the person obtaining them. Of these, ordinary contracts of marine, fire and life insurance are examples, and in each of them the person desiring to be insured must, in setting forth the risk to be insured against, not conceal any material facts affecting the risk known to him. On the other hand, ordinary contracts of guaranty are not amongst those requiring *uberrima fides* on the part of the creditor towards the surety, and mere non-communication to the surety by the creditor of facts known to him affecting the risk to be undertaken by the surety will not violate the contract, unless there be fraud and misrepresentation; and misrepresentation, undoubtedly, might be made by concealment. But the difference between these two classes of contracts does not depend upon any essential difference between the word 'insurance' and the word 'guaranty.' There is no magic in the use of these words. The words, to a great extent, have the same meaning and effect; and many contracts like the one before us may, with equal propriety, be called contracts of insurance or contracts of guaranty.

"Whether the contract be one requiring *uberrima fides* or not must depend upon its substantial character and how it came to be effected. There is no hard and fast line to be drawn between contracts of insurance and contracts of guaranty for the purpose for which I am now considering them, and certainly the rule as to the contracts of

insurance is not limited or confined to the three forms of marine, fire and life insurance. Now, when contracts of insurance are considered, it will be seen that, speaking generally, they have in common several features in their characters and the way they are effected which distinguish them from ordinary contracts of guaranty. Contracts of insurance are generally written speculations where the person desiring to be insured has means of knowledge of the 'risk,' and the insurer has not the means or the same means. The insured generally puts the risk before the insurer as a business transaction, and the insurer of the risk stated fixes a proper price to remunerate him for the risk to be undertaken, and the insurer engages to pay the loss incurred by the insured in the event of certain specified contingencies occurring. On the other hand, in general, contracts of guaranty are between persons who occupy or ultimately assume the positions of creditors, debtors and surety, and thereby the surety becomes bound to pay the debt or make good the default to the debtor. In general, the creditor does not himself go to the surety, or represent or explain to the surety the risk to be run. The surety often takes the position from motives of friendship to the debtor, and generally not on the result of any direct bargaining between him and the creditor, or in consideration of any remuneration passing to him from the creditor. The risk undertaken is generally known to the surety, and the circumstances generally point to the steps that, as between the creditors and the surety, it was contemplated and intended that the surety should take to ascertain exactly what risk he was taking on himself. In all the reported cases of guaranty that I have been able to find in which it has been held that the party guaranteed owed no duty to the guarantor as to disclosure of material facts, the contracts when examined are found to have in substance, though of course not in every detail, the characteristics which distinguish contracts of guaranty from contracts of insurence, as above stated. Applying the above consideration to the contract in the case before us, it appears to me that the contract is one which required *uberrima fides* on the part of the insured."[1]

The modern doctrine of concealment, in so far as it is applicable to fidelity insurance, is fully and clearly set forth in National Bank of Asheville *v.* Fidelity and Casualty Company of New York,[2] decided by the federal court of appeals for the

[1] The foregoing case was reversed in the House of Lords, in Seaton *v.* Bernand, 1900, L. R. App. Cas. p. 135.

[2] 89 Fed. 819; 32 C. C. A. 355.

fourth circuit. The facts in this case were as follows: One Pulliam was bonded as cashier under a policy which covered acts of fraud or dishonesty on his part committed during the continuance of the term from October 1, 1889, to October 1, 1890, or any renewal thereof. There was no new policy issued, but it was continued in force by the payment of the annual premium. This premium for the year commencing October 1, 1893, was not paid until January 2, 1894, before which time Pulliam, to the knowledge of the bank's officials, had been guilty of dishonesty. This fact was not communicated to the insurer, and the failure to do so was set up in defence of an action on the policy thereafter brought by the insured. In passing upon this contention the court spoke as follows:

"This was not a case such as frequently may arise where, through carelessness, the officers of a bank have failed to discover the facts which would exhibit dishonesty of an employee, but the effort of the defendant was to show that the president, when about to obtain a renewal, knew facts which pointed directly to the default; and if he could truthfully say he did not know of the default, it was because he did not draw from these facts the conclusion which a reasonable man would, and did not attempt, as a reasonable man would, to verify the import of these facts by looking at the entries in the bank accounts; in fact, that he wilfully refrained from any investigation or reasoning, in order that he might avoid knowledge. . . .

"It is true that under this class of bonds the surety is not discharged because the employer might, by the exercise of diligence, have known the state of his accounts, or might with more care have sooner discovered the dishonesty and prevented the loss. But that was not the matter in controversy in this case. There were in this case very few material conflicts of testimony. There was, first, the dispute as to whether there had been an agreement in November to renew the bond; second, whether the premium was paid on January 2 or January 4; third, whether the facts known to the bank's officers showed to a person bestowing reasonable care upon the matter that Pulliam was a defaulter; and, fourth, whether these facts were withheld from defendant's agents with a fraudulent purpose. It was possible for the president to say he did not know that Pulliam was a defaulter, notwithstanding he knew the facts connected with his unaccounted-for disappearance with the $5000 with no statement of where he was going.

It was possible for the president to choose to retain his faith in him and to believe there would be some explanation of Pulliam's conduct; but if the jury found under the first issue that a man exercising reasonable care could not, in the face of known facts, in good faith conclude that there was no defalcation, while at the same time he was so influenced in his conduct by the same facts that he sent in haste to pay for and obtain the renewal receipts, then the jury properly answered the first issue, yes. The trial judge instructed the jury that the burden was upon the defendant company to prove that the plaintiff's officers had knowledge of the defalcation, and in substance told the jury that if they found that the bank's officers were in possession of facts with regard to the defalcations, which, if made known to the agent of defendants, would have stopped them from issuing the renewal receipts, and suppressed those facts with the fraudulent intent to induce the agents of the company to bind their principal with a contract which they would not have made if the facts were disclosed, then they should answer the second issue, yes. The judge several times reiterated to the jury that the question was whether, with the intent to deceive and defraud the defendant, the plaintiff's officers suppressed the knowledge which they had of facts which should have led a reasonable man to know that Pulliam was a defaulter. It is to be observed in this case that the evidence discloses that Pulliam himself had refused to have his honesty any longer guaranteed by the defendant. He was a party to the contract, signed the original agreement, which recited that he had applied to the defendant for the grant by it of the bond, but he declined the offer to renew it. The jury must have found that there was no agreement for renewal until January, 1894, and it is apparent that, as Pulliam had then absconded, the renewal in January was at the solicitation of the bank at a time when there was no obligation of any kind resting upon the defendant, and the case became one where the party to be indemnified solicited the surety to become bound. Under this state of the case it cannot be gainsaid that concealment of facts known to the employers, which would lead a reasonable man to make inquiries or look at entries which would at once disclose the defalcation, would discharge the surety, if the concealment was made with the fraudulent intent to induce the surety to enter the suretyship. The fraudulent intent was inferable in this case from the urgent haste of the bank's president to obtain the renewal receipts as soon as the fact that Pulliam had gone off with the $5000 and the teller's suspicions became known to him, whereas he had before been indifferent about the renewal, although the fact that the bond had not been renewed had been pressed upon

his attention two months before. Many of the plaintiff's exceptions to the court's charge are apparently based upon the theory that the defence rested upon the neglect of the officers of the bank to use reasonable care in watching the cashier in order to prevent defalcations by him; but that was not at all a question in this case. The question here was, Could the bank officers, by suppressing facts which they did know, get a surety to renew a guaranty so as to cover a defalcation which they had reason to know had already occurred? We think that under the instructions of the court, as a whole, this issue was fairly placed before the jury."

In another case, where a fidelity insurance policy recited that the insured had delivered to the insurer certain statements relative to the duties and accounts of the treasurer, which, it was agreed, should form the basis of the contract expressed in such policy, the court laid down the following as a general principle applicable to all such cases; to wit, that, if such statements involve no misrepresentation or concealment of facts, about which formal inquiries had been made by the insurer to the insured, then the contract could not be affected by concealment of facts about which no inquiry was made, or conduct on which no reliance was placed.[1]

In the case of the Fidelity and Deposit Company of Maryland *v.* Commonwealth [2] the Kentucky court of appeals used these words:

"To sustain this position that the surety is released, counsel for appellant relies upon that principle of law which is to the effect, if a party taking a guaranty from a surety conceals from him facts which go to increase his risk, and suffers him to enter into a contract under false impressions as to the real state of facts, such concealment will amount to a fraud, because the party is bound to make the disclosure; and the omission to make it under such circumstances is equivalent to an affirmation that the facts do not exist. This principle of law is applicable to transactions between individuals, and between individuals and corporations, but does not apply to public officials."

§ 63. **What Concealment is effectual to discharge the Insurer from Future Liability under the Policy.** — In view

[1] Sup. Cl. Cath. Kn. of Am. *v.* F. & C. Co. of N. Y., 63 Fed. 48; 11 C. C. A. 96.

[2] 20 Ky. L. Rep. 788, 1402; 47 S. W. 579; 49 S. W. 467.

of the general refusal of the courts to apply the doctrine of spontaneous disclosure to contracts of fidelity insurance, the cases are very limited where, in the absence of contractual obligation to speak, concealment on the part of the insured, even of material facts, has been held to relieve the surety from liability. Particularly is this true in cases where the "risk" occupies an official public position. Here the courts uniformly refuse to relieve the insurer on any such ground.[1]

The only case where it is universally held that the concealment serves to relieve the insurer is in the case of private "risks" where the insured himself solicits the insurance under circumstances from which an intent on his part may be inferred to defraud the insurer into assuming a liability in fact already existing, but which is concealed from it by the insured. In such a case it is presumed that the concealment was with fraudulent intent, and it will serve to relieve the insurer from liability on the policy issued under such circumstances.[2]

So, too, it is believed that after liability is assumed, actual knowledge of acts of dishonesty on the part of the "risk" covered by the policy with retention of the "risk" in the insured's employment and concealment of such dishonesty from the insurer, constitutes such fraud and bad faith on the part of the insured as will serve to relieve the insurer from further liability under the policy.

Upon this general subject the words of the court in Herbert *v.* Lee, *et al.*,[3] are directly in point. In that case the court spoke as follows:

"We think there can be no doubt that the mere failure upon the

[1] Fid. & Dep. Co. *v.* Commonwealth, 47 S. W. 579; 20 Ky. L. Rep. 788, 1402; Ind. School Dis. *v.* Hubbard & Am. Sur. Co., 81 N. W. 241; 110 Ia. 58; see also *post*, § 165.

[2] See U. S. Fid. & Guar. Co. *v.* Blakely Hurst & Co., 117 Ky. 127; 77 S. W. 709; Nat. Bank of Asheville *v.* F. & C. Co. of N. Y., 98 Fed. 819; 32 C. C. A. 355; Fid. & Dep. Co. *v.* Commonwealth, 47 S. W. 579; 20 Ky. L. Rep. 788, 1402; Am. Cr. Ins. Co. *v.* Wimpfheimer, *et al.*, 43 N. Y. Sup. 909; 14 N. Y. App. Div. 498; Sherman *v.* Harbin, 125 Ia. 175; 100 N. W. 629.

[3] 118 Tenn. 133; 101 S. W. 175.

part of the complainant to inform its sureties of the fact that their principal, Lee, had fallen behind from time to time in his accounts as agent until his liabilities had amounted, at the execution of these bonds, to the sums stated, would not be sufficient to relieve them from liability. If the present case was that — in other words, if this was a case in which the agent was simply behind in his accounts, and the complainant had failed to communicate, in the absence of investigation or inquiry upon the part of the sureties, this fact to them, we think this would not constitute a ground for resisting a recovery on these bonds. But the court of chancery appeals does not leave the action in that condition. That court finds, in words which are capable of no other construction, that at the time of the execution of these several bonds Lee's liabilities grew out of the embezzlement of his principal's funds, and that he was at each of these dates a defaulter within the knowledge of the complainant.

"We think upon this finding of facts that a failure on the part of the obligee to communicate the criminal conduct of Lee, out of which the existing indebtedness occurred at the time of the making of these bonds, to the sureties upon them, although not inquired of by the sureties, was such conduct on his part as to relieve the sureties from liability.

". . . The rule is otherwise if the acts of the agent, undisclosed to his surety, do not involve moral turpitude, but are such as are consistent with honesty and only tend to show that the agent is dilatory, or unskilled. In such case the law does not impose the duty upon the obligee, unasked, to give the surety information of such facts.

". . . It is true, as has been stated, that the complainant had no communication with the sureties upon these bonds, and that they were presented to and signed by them at the instance of Lee, their principal; yet, we think this fact does not prevent them from availing themselves of the principle expressed in Phillips *v.* Foxhall, *supra*, and the other cases, to which reference has been made. The bonds were sent out by the complainant to Lee in order that he might obtain sureties upon them, and we can see no distinction between this case and one where the obligee personally presents the bond to the surety and obtains his signature to it, knowing at the time that the agent had been guilty of criminal offence theretofore in the management of his agency and fails to communicate the fact to the surety. The presentation of the bond, without more, is an implied assurance, at least, that the agent has been guilty of no criminal delinquency in the management of the affairs of his agency; and we think the surety is as well discharged in the one case as in the other, if, without any

knowledge of the existence of such default, he signs the bond. Nor do we think that the liability of these sureties, in view of the finding that Lee had been guilty of embezzlement of the obligee's funds theretofore, is affected by the recital in these bonds that the sureties undertook to become liable, not only for the debts that might be incurred by Lee after the date of these bonds, but such moneys as he might owe to the obligee growing out of the affairs of his agency at that time. In the absence of the element, which we find as a matter of law goes to the discharge of these sureties, there is no doubt upon these bonds that these sureties would have been liable not only for debts incurred thereafter by Lee in the course of his agency, but for debts then existing. But the knowledge of the obligee that these debts were the result of dishonest dealings upon the part of Lee uncommunicated to the sureties in spite of this recital can be availed of by the sureties in order to defeat recovery on these bonds."

In a recent Iowa case [1] it was held that the insured (a mutual benefit association) was under no obligations to notify the insurer which had issued for its benefit a fidelity insurance bond on one of its employees, of the wrongful act of the "risk" therein named in misappropriating assessments collected by the association and simply held in trust by it for the payment of specific accounts, to the payment of other losses or the expenses of litigation where the insured did not have actual knowledge of the wrongful act of such officer. The court in its opinion spoke as follows:

"The authorities agree that all interrogations by the insurer must be candidly and truthfully answered. But what should be required of the insured in the absence of an inquiry? If the surety is absent, so that no direct communication can be made, the obligee is not under obligations to search out the surety and warn him of the danger of the step he is about to take. In such a case he has a right to assume that all the information desired has been obtained from the principal. The same rule necessarily applies, even though the surety be present when all the facts are as accessible to the surety as to the obligee, for the latter is not bound to aid the surety in determining the propriety of entering into the contract. . . .

"We have not found any case deciding that in no event is the obligee obliged to disclose his knowledge of the past conduct of the

[1] Sherman *v.* Harbin, 125 Ia. 175; 100 N. W. 629.

principal in the absence of inquiry, nor, on the other hand, is there any decision saying that such information must always be given if opportunity is afforded. Statements of this character have been incorporated in some text-books, however. What is exacted necessarily depends on the circumstances of each particular case, but certainly the information which must be imparted should relate to the subject-matter of the suretyship, as certainly the situation must be such that the obligee as a matter of fairness ought to state what he knows, and the omission to do so may be attributed to an intention to withhold information in aid of some advantage to himself. In other words, there must be an intent in some way to mislead, either by silence or what is said, for without an improper motive there can be no fraud such as to invalidate the contract. If the bond is tendered by, or received from, the surety under conditions indicating that the obligee must have known the surety was acting without knowledge of past conduct increasing the risk about to be assumed and which might have deterred him from executing the bond, and so knowing, the obligee takes the bond without disclosing the facts constituting such misconduct, though having the opportunity to do so, he may well be held guilty of fraudulent concealment. But he is not bound to assume ignorance on the part of the surety nor to advise him unless he has reason to suppose the surety is acting in ignorance of the facts within his knowledge, increasing the hazard of what he is about to do, for the burden of guarding the latter's interest is in no way cast upon the obligee."

There is no principle of law better settled than that persons proposing to become sureties to a corporation for the good conduct and fidelity of an officer to whose custody its moneys, notes, bills and other valuables are entrusted, have the right to be treated with perfect good faith. If the insured is aware of secret facts materially affecting or increasing the obligations of the insurer, the latter is entitled to have these facts disclosed to it by proper proof being presented.[1]

[1] U. S. Fid. & Guar. Co. *v.* Blakely Hurst & Co., 117 Ky. 127; 77 S. W. 709; 85 S. W. 96; see also F. & C. Co. *v.* Bank of Timmonsville, 139 Fed. 101; Herbert *v.* Lee, *et al.*, 118 Tenn. 133; 101 S. W. 175.

CHAPTER X

(V) DISCHARGE OF LIABILITY BY BREACH OF WARRANTY

§ 64. **Warranty discussed and defined.** — A warranty is a formal assurance, either inserted in the policy, or made a part thereof by reference therein to other instruments, by the insured to the insurer as to the existence, either past, present or in the future, of some fact or state of facts material to the contract between the parties. Ordinarily its effect is to induce the insurer more readily to assume the liability imposed by such a contract, by diminishing the estimate he might otherwise have formed as to the chance of being compelled to make good any liability that might be created by reason of his entering into the proposed contract. It is important in order to avoid confusion to compare briefly " warranties " with the closely allied subjects of " representations " and " conditions." A warranty in the law of fidelity insurance is a binding agreement that the facts stated by the insured in his proposal for an insurance policy are true.[1] When contrasted with a representation, the latter may be defined as a statement by an applicant for fidelity insurance regarding a fact material to the proposed insurance which must not only be false but fraudulent to defeat the policy.[2] A representation is distinguished from both a warranty and a condition in that it is a mere declaration of a fact and not a part of the contract; neither is its truth a condition precedent to the insured's recovery on the insurance policy. Warranties on the other hand are conditions precedent, and like the more formal conditions are a part of the contract of insurance.[3] The doctrine of warranty is based upon the proposition that a very high degree of candor is required of

[1] Rice *v.* Fid. & Dep. Co., 103 Fed. 427; 43 C. C. A. 270.

[2] *Idem.*

[3] Rice *v.* Fid. & Dep. Co., 103 Fed. 427; 43 C. C. A. 270; Am. Cr. Indemn. Co. *v.* Wood, *et al.*, 73 Fed. 81; 19 C. C. A. 264.

the insured in answering inquiries which he knows are to be used as the basis of the contract of insurance which he is about to enter into with the insurer.[1]

§ 65. **Warranties, how created?** — Speaking in general terms it may be said that the courts are reluctant to impart terms of warranty contained in the application or proposal for bonds of fidelity insurance into the completed agreement, unless the policy clearly manifests the agreement of the parties to the union of the two instruments in one contract.[2] To create a warranty as to any matter, the insurer who prepares the policy must insert therein, as well as in the application and proposal, apt and unequivocal language to render certain that the parties to the contract intended to transform what would otherwise be mere representations into warranties. Warranties in fidelity insurance are almost invariably evidenced by being set forth only in the application or proposal, which are themselves referred to in the policy as constituting the basis of the proposed fidelity insurance policy and as being deemed warranties between the parties to the contract. Wherever there is a distinct agreement that the application is a part of the insurance contract and the statements in the application upon which such contract is based are expressly declared to be warranties, the intent of the insured to bind himself to exactness of truth in his answers, although the facts which are called for may not seem material, is clearly and adequately manifested and the contract must then be enforced according to its terms.[3]

Whether the parties to the contract of insurance have made questions and answers in fidelity insurance policies material

[1] Phil. Horse Car Co. *v.* F. & C. Co., 160 Pa. St. 350; 28 Atl. 823; see also generally U. S. to the use of Heise Bruns & Co. *v.* Am. Bond. & Tr. Co., 89 Fed. 921, 925; 32 C. C. A. 420; First Nat. Bank of Nashville *v.* U. S. Fid. & Guar. Co., 110 Tenn. 10; 75 S. W. 1076.

[2] See Am. Cr. Ins. Co. *v.* Car. Fur. Mfg. Co., 95 Fed. 111; 36 C. C. A. 671.

[3] Am. Cr. Ins. Co. *v.* Car. Fur. Mfg. Co., *ante;* Dime Sav. Ins. *v.* Am. Sur. Co., 68 N. J. L. 440; 53 Atl. 217; U. S. Fid. & Guar. Co. *v.* E. S. S. & F. Co., 148 Fed. 353.

and in effect warranties is a question of law for the court to determine, by a fair interpretation of the contract.[1]

In this connection it is to be noted that for purposes of construction by the court it is immaterial whether the statements of the insured in the proposals are called warranties or not.[2] If it is a stipulation embodied in the contract by the parties as to the truth of the matters therein stated, whether relating to past, present or future events, it is in law a warranty.[3] Where a policy guaranteeing the fidelity of a bank cashier stated that certain statements made by the insured in the application were to form the basis thereof, and that it was granted on condition that the insured's business should remain in every particular in accordance with such statements, and that if any change should be made without notice to, and approval by, the insurer, it should be void, it was held to constitute a warranty.[4]

In a late case the application was in the form of answers to questions and by the terms of the policy the statements in the former were to "constitute an essential part and form the basis of the contract." The application expressed that the answers were true to the best of the knowledge and belief of insured, and were to be taken as the basis of the contract. It was held, that such promissory statements amounted to a warranty, notwithstanding the word "warranty" was not used, and that the words "to the best of the knowledge and belief" of insured related only to such statements as respected facts existing at the time, or previously, and not to the promissory statement.[5]

The general rule in this immediate connection is well set forth by the New Jersey Supreme Court in Dime Savings

[1] See Stensgaard *v.* St. P. R. E. Tit. Ins. Co., 50 Minn. 429; 52 N. W. 910.

[2] Livingston, *et al.* *v.* Fid. & Dep. Co., 76 Ohio 253; 81 N. E. 330.

[3] Fid. & Dep. Co. *v.* Courtney, 103 Fed. 599; 43 C. C. A. 331.

[4] Dougherty *v.* London Guar. & Acc. Co., 6 Vic. L. Rep. (law) 376.

[5] Hunt *v.* F. & C. Co., 99 Fed. Rep. 242; 39 C. C. A. 496; see also Max J. Wrinkler Brok. Co. *v.* Fid. & Dep. Co., 119 La. 735; 44 Sou. 449.

Institution *v.* American Surety Company.[1] The court there said that to make the statements of the insured given at the time of the execution of the policy binding as warranties, they must either appear upon the face of the policy or must by inference be incorporated therein. If this is not done, they will then be treated as representations and not as warranties.[2]

§ 66. **Does the Doctrine of Warranty prevailing in Fire, Life and Marine Insurance apply to Contracts of Fidelity Insurance?** — The doctrine of the courts with respect to warranties in fire, life and marine insurance may be briefly stated as follows: Irrespective of the materiality of the fact or circumstance warranted to the contract about to be entered into, such fact or circumstance, if the warranty respecting the same be violated, will serve to relieve the insurer from all liability under the policy issued, upon the consummation of the contract to which such warranty related. The doctrine under discussion is in effect that all warranties, affirmative or promissory, are in effect conditions precedent to a recovery, the terms of which must be strictly fulfilled by the assured, for upon their non-performance the contract is avoided. No more vital or important question can be raised in the entire field of fidelity insurance than the one now before us. Does the doctrine of warranty, as just outlined, in respect to fire, life and marine insurance, apply as well to contracts of fidelity insurance? In American Surety Company *v.* Pauly[3] the United States Supreme Court did not have occasion to consider statements contained in the application in the light of a breach of warranty, for the reason that the insurance policy before the court for construction in that case did not make such statements warranties, and the matter was treated by the court as a case of misrepresentation merely.

[1] 68 N. J. Law 440; 53 Atl. 217.

[2] See also Guthrie Nat. Bank *v.* Fid. & Dep. Co., 14 Okla. 632; 79 Pac. 102; Champion Ice & Cold Storage Co. *v.* Am. Bond. & Tr. Co., 115 Ky. 863; 75 S. W. 197; Model Mill Co. *v.* Fid. & Dep. Co. of Md., 1 Tenn. Ch. Ap. Rep. 365; Max J. Wrinkler Brok. Co. *v.* Fid. & Dep. Co. of Md., 119 La. 735; 44 So. 449.

[3] 170 U. S. 133.

But in more recent cases this same tribunal has had occasion to adopt the rule that exists in other branches of insurance law relative to breaches of warranty.[1]

There is no doubt that at the present time there is a very decided tendency on the part of the courts of highest standing to engraft, without change or qualification into the law of fidelity insurance, the doctrine of warranty as it exists to-day in fire, life and marine insurance. It is difficult to see how the courts can consistently do otherwise. They have almost universally recognized the bonds issued by the "surety companies" as contracts of insurance, and this, too, without qualification or reservation. The moment this much is conceded, the incidents of insurance law should naturally follow. This is certainly true in the absence of any substantial reason for differentiating fidelity from other forms of insurance, in so far as the application of the doctrine of warranty thereto is concerned. None such have been so far pointed out, and it is difficult to conceive of any.

What is believed to be the true and better doctrine in this connection is that set forth by the federal court of appeals for the eighth circuit in Rice *v.* Fidelity and Deposit Company of Maryland.[2] The able opinion in that case was written by Judge Sanborn, who applied the doctrine of warranty, as it exists in fire, life and marine insurance, to a policy of fidelity insurance. Similar conclusions have been arrived at by so many other courts as to afford a safe basis for the statement that the doctrine of warranty in the form recognized in fire, life and marine insurance is likewise applicable to fidelity insurance contracts.[3]

[1] See Guar. Co. of N. A. *v.* Mech. Sav. Bank & Tr. Co., 183 U. S. 402; Fid. & Dep. Co. *v.* Courtney, 186 U. S. 342; see Pacific Fire Ins. Co. *v.* Pacific Sur. Co., 28 Pac. 842; McNichols *v.* Can. Guar. Co., 4 L. N. Ch. 78.

[2] 103 Fed. 427; 43 C. C. A. 270.

[3] Indemn. Co. *v.* Wood, 19 C. C. A. 264; 73 Fed. 81; Am. Cr. Indemn. Co. *v.* Car. Fur. Mfg. Co., 36 C. C. A. 671; 95 Fed. 111; Monongahela Coal Co. *v.* Fid. & Dep. Co. of Md., 94 Fed. 732; Harbor Commissioners *v.* Guar. Co., 22 Can. Sup. Ct. 542; London Guar. & Acc. Co., 26 Ont. Rep.

§ 67. What is the "Doctrine of Warranty" in Fidelity Insurance? The doctrine of "affirmative warranty," as it may be said to exist in fidelity insurance, may be stated as follows: Whenever by the terms of the policy prior representations, made by the insured to the insurer, relative to past events or existing facts and having a direct bearing upon the proposed liability about to be assumed, are declared to be warranties, then, in an action on the policy the insured is bound by them and must establish their truth or else fail of recovery. This, too, even when they have been made in the utmost good faith and with reasonable ground to believe that they are true.

The doctrine of "promissory warranty" in fidelity insurance may be stated in the following language: Whenever by the terms of the policy, prior representations, made by the insured to the insurer relative to the future conduct of the insured in respect to the duties, responsibilities and supervision of the "risk" whose faithful performance of duty to the insured is to be covered by such policy, are made warranties, then, a faithful compliance with all such representations relative to the liability to be assumed is a condition precedent to any recovery on the bond. Here again the elements of good faith and reasonable care have no application. The truth of the representations is absolutely warranted. The good faith of the party making them or their materiality has no legal bearing in actions involving breaches of warranty. The warranty must be substantially if not strictly complied with.[1]

The law is well settled in its application to insurance contracts that a misrepresentation of a material fact, in reliance upon which the contract of insurance is issued, will void the

520; Stensgaard *v.* St. P. R. E. Tit. Ins. Co., 50 Minn. 429; 52 N. W. 110; Gaines *v.* F. & C. Co., 188 N. Y. 411; 81 N. E. 169; Guar. Co. of N. A. *v.* Mech. Sav. Bank & Tr. Co., 183 U. S. 402; Fid. & Dep. Co. *v.* Courtney, 186 U. S. 342; Trustees *v.* Fid. & Dep. Co., 76 Ohio 253; 81 N. E. 330.

[1] See Rice *v.* Fid. & Dep. Co., 103 Fed. 427; 43 C. C. A. 270.

contract, and it is not essential in equity that such a misrepresentation should be known to be false. A material representation whether made intentionally and knowingly or through mistake and in good faith will void the policy.[1]

Written statement, made by a corporation accompanying the application to a bonding company guaranteeing the honesty of employees, which statements relate to the past conduct of the employees in their services as such and are intended to and enter into the contract and become the inducement in part for the issuing of the bond are in their nature warranties, and their falsity in any material particular will defeat recovery on the bond for the delinquency of such employees.[2] In this connection attention is called to the decision of the Ohio Supreme Court in the case of Livingston, *et al.* *v.* Fidelity and Deposit Company.[3] In that case the court spoke as follows:

"What is the nature and effect in law of the representations and promises made by the insured to the insurer to induce the bonding contract?

"It is assumed that the bonding contract with the continuation certificates are in the nature of insurance contracts rather than surety contracts, and it is contended that the effect of the statements deemed representations and promises are not to be treated as warranties, but are merely representations and to be determined by the rules applicable to insurance contracts; that is, unless the statements are known to be untrue when made their actual falsity does not prejudice the rights of the insured. An extensive array of authorities is produced to show that the language of such contracts should be construed most strongly against the insurer, since the terms are specified by the latter and not by the insured. It is perhaps not necessary to look beyond our own state to ascertain the correct rule. Being contracts of indemnity against loss, such contracts should be liberally construed in favor of the object sought to be bonded, and where a clause is supportable of two interpretations which seem equally fair, that should be preferred which affords greater indemnity and should like other contracts receive a reasonable construction in order to carry out the pre-

[1] U. S. Fid. & Guar. Co. *v.* First Nat. Bank of Dundee, Ill. ; 84 N. E. 670.

[2] *Idem.*

[3] 76 Ohio 253; 81 N. E. 330.

sumed intention of the parties as expressed by the language used. The question of what name should be given to the representations and promises of the loan company seem to us unimportant. . . . These statements, relating as they do to past transactions and existing conditions and to promises as to future conduct of employees should enter into the contract and were at least in part the inducement which led to it and which constitute the basis of liability on the part of the insurer, and although the term 'warranty' is not used, yet they, in law, had the effect of warranties; so that their falsity in any material particular is fatal to any action on the bond. That the statements were both false and material admits of no dispute. That the insured had no personal knowledge of their falsity is immaterial. They were the representations of the insured and that they were grossly false was well known to those who were in active management of the insured's affairs. The knowledge of those actively participating in the management of a corporation is held to be in law the knowledge of the corporation itself. The proof of such knowledge is not essential to the responsibility of the insured for the truth of the statements made. The statements were conditional to the taking effect of the stipulations for liability on the part of the insurer, were statements that certain facts were true and that certain acts respecting the performance of duties should thereafter be done by officers of the loan company. These statements however expressed are of the very essence of warranties. The promises were to be observed in good faith; the representations as to the conduct of the 'risk' and the condition of his accounts and transactions with the insured could not truthfully be made unless they were the result of a reasonable examination and supervision of the conduct of such employees and their dealings which affect the business of the insured. As before stated, no real effort to control or supervise the 'risk' was attempted, and he was allowed practically to manage the whole affair to suit himself. The duties of their officers were defined in the insured's statements accompanying their several applications, and it was part of the contract that these duties should not be changed without notice to the insurer. No such notice was given. On the contrary, the last statement of the insured implies that the concerns are being managed by the insured in accordance with the previous stipulation. It does more than this. We emphasize the fact that it contains a positive statement that each of the 'risks' named has faithfully and satisfactorily performed his duties. In fact some had actually abandoned their duties. It stated positively that they had promptly and correctly rendered accounts during the year ending June 1, 1901. Some of them had rendered no

accounts whatever during that year. The examination of the alleged expert was made in December. The foregoing are positive statements. The certificate doesn't say that to the best of the insured's knowledge and belief neither of the 'risks' named had been or was in arrears or default. . . . The existence of no previous intelligent effort on the insured's part to ascertain the truthfulness of the statements, when taken with the real facts as they existed, shows not only a failure on the part of the insured to perform its part of the contract, but a reckless disregard of contract obligations. Can any intelligent person suppose that if the method of management had been disclosed as fully as it was concealed, the bond would ever have been renewed by the defendant company? We think not. It appears to us clear that the representations and promises were in law warranties and the falsity of the former and the disregard by the loan company of the latter constituted a complete defence."[1]

The Iowa Supreme Court observed in a recent case that the failure of a warranty of a material fact or one made material by the terms of the policy or the conditions thereof when construed is equivalent to a warranty if acted upon in issuing the policy of insurance and will defeat recovery thereon.[2] It is, of course, incontrovertible that recovery cannot be had on a policy insuring against loss by dishonesty of an employee where it is distinctly stipulated both in the policy and the application therefor, that answers to questions in the application for such bond are to be taken as conditions precedent and as the basis of the bond applied for. If the answer to questions on material matters pertaining to the issuance of such policy contained therein are untrue, though not known to the applicant to be untrue, and even where there is no bad faith on the part of such applicant, nevertheless the untruth of such answers will serve to void the policy.[3]

Where a fidelity bond provided that any wilful misstatement or suppression of fact by the employer concerning the employee should render the bond void, a mere belief on the part of the

[1] See to the same effect Model Mill Co. *v.* Fid. & Dep. Co., 1 Tenn. Ch. App. 365.

[2] Perpetual Bldg. & Loan Ass. *v.* U. S. Fid. & Dep. Co., 118 Ia. 729; 92 N. W. 686.

[3] Model Mill Co. *v.* Fid. & Dep. Co., 1 Tenn. Ch. App. 365.

employer's president that it was immaterial whether the questions asked were necessary or not do not render such answers immaterial.

The Kentucky court of appeals in a recent case held that where representation in an application for an employee's fidelity bond were materially false, the bond was thereby rendered invalid, and they further held that the question whether such representations were fraudulent or not was immaterial.[1]

§ 68. **Warranties classified.** — Warranties may be properly divided into two classes: affirmative and promissory.

Affirmative warranties relate exclusively to facts as they exist in past or are in present time, and usually form the basis of the contract of fidelity insurance subsequently entered into between the parties.

Promissory warranties relate, on the other hand, exclusively to future events, and arise when the insured expressly covenants to perform some executory stipulation of a nature calculated to limit the opportunities for successful fraud or dishonesty on the part of the "risk." They seek in effect to transform mere naked declarations of intention as to a line of conduct to be pursued by the insured into an express agreement to pursue that line of conduct, at the peril of relieving the insurer of liability under the policy in case it is not so pursued.[2]

§ 69. **Affirmative Warranties discussed.** — An affirmative warranty, like certain of the covenants in a warranty deed, if breached at all, becomes so as soon as made. They arise, as do all warranties in this branch of insurance law, by the insertion of apt words in the body of the policy, whereby certain material facts as set forth either in the proposal or application are incorporated into and become part of the policy itself. In

[1] Warren Dep. Bank *v.* Fid. & Dep. Co., 116 Ky. 38; 74 S. W. 1111; see also Guar. Co. of N. A. *v.* Mech. Sav. Bank & Tr. Co., 46 L. E. 253; 183 U. S. 402.

[2] See Pacific Fire Ins. Co. *v.* Pacific Sur. Co., 93 Cal. 728; Pac. 842; McNichols *v.* Can. Guar. Co., 4 L. N. Can. 78.

this connection the words of the New York court of appeals[1] are directly in point. This was an action brought to recover on a fidelity insurance bond which had been issued upon representations contained in the application for the policy. The court in its opinion spoke as follows:

"This was, however, a distinctly expressed warranty, the truth of which was a condition of liability, and was of the basis of the contract itself. The effect of making the statement a part of the policy and of warranting it to be true, was, in law, to induce the defendant's agreement to insure, and the statement became material. It is a general rule, and one which the decisions of this court have asserted, that the materiality of the fact stated by the assured is of no consequence, if the contract be that the matter is as represented, and that unless it proves so, whether from fraud, mistake, negligence or other cause, not proceeding from the insurer, or the intervention of the law or the act of God, the other can have no claim. . . . 'One of the very objects of the warranty is to preclude all controversy about the materiality or immateriality of the statement.' The parties to this contract had the right to make any statements of fact material thereto and conditions precedent to any liability thereupon, all things being equal at the time in their attitude to each other, and if they proved false, the contract was avoided. The insurer was entitled to know the actual relationship which the person, for whom the insured desired the benefit of the insurance contract, sustained to him, for it bore upon the risk which it was to assume. The inquiry related to the risk; the statement in the answer was made a warranty to be contained in the policy, and, it having been determined that the statement was untrue, the right to recover upon the contract was forfeited."

The Ohio Supreme Court in Livingston, *et al.* *v.* Fidelity and Deposit Company[2] has held that written statements made by a corporation accompanying an application to a bonding company for a bond guaranteeing the honesty of employees, which statements relate to the past conduct of such employees in their service as such, and which intend to and do enter into the contract and become the inducement in part for the issue of the bond, are in the nature of warranties, and their falsity in any material particular will defeat recovery on the

[1] Gaines *v.* F. & C. Co., 188 N. Y. 411; 81 N. E. 169.
[2] 76 Ohio 253; 81 N. E. 330.

bond for the delinquency of such employees. Thus, for example, a clause reading like the following has the effect in law of transforming an affirmative representation as contained in a proposal or application into affirmative warranties:

"Whereas the insured has delivered to the insurer certain statements and declarations relative to the duties and accounts of the 'risk,' the manner of conducting the business of the insured and other matters which do and shall constitute warranties and form the basis of this contract."

The statements and declarations here referred to are the proposals and applications for the policies filed respectively by the insured and the "risk" with the insurer, and which themselves usually contain the express provision that all matters therein contained are to be considered warranties and shall form the basis of the guaranty therein applied for. Just what these affirmative warranties consist of, it will be our purpose now to state. They customarily relate to the following matters:

1. Age of "risk" and place of birth.
2. Statement as to whether "risk" is married or single.
3. Business history of the "risk."
4. Financial condition of "risk."
5. Amount of life insurance carried by the "risk."
6. Whether "risk" has been in arrears in previous employment either by the insured or third parties.
7. Whether "risk" has been required to and given bonds in previous employments.
8. Whether application for policy has ever been refused or not.
9. Membership of the "risk" in secret organizations.
10. Amount of outstanding debts and liabilities.
11. Date of last auditing of "risk's" accounts and conditions of same at that time.
12. Whether "risk's" accounts have been examined and found correct just prior to the time the policy or its renewal was applied for.

It can readily be seen from even a cursory examination of the foregoing matters that they do not all have the same equal and direct bearing on the nature and extent of the liability the insurer is asked to assume. Age, family and social ties, financial condition, business history and ability to procure policies from other companies, while each has some bearing on the extent of the liability that the insurer is requested to bear, yet their chief value is an aid to the determination of the question as to whether the application for a policy shall be acted upon favorably or not.

On the other hand, those questions which relate to the existence of arrears in previous employments, to the correctness of the prospective "risk's" accounts or to an examination occurring just prior to the filing of an application for a policy, all have a direct and material bearing as being material to a determination by the insurer of a probable chance of ever being compelled to make good a defalcation of such "risk" if the policy requested be issued. Such questions go to the very heart of the theory upon which guaranty insurance is based; that is, the weighing in the aggregate of a large number of premiums against possible loss from being compelled to make good a part of the liability assumed on an equal number of average "risks." The information sought in the case of these last-mentioned questions is material, is peculiarly within the knowledge of the party seeking the insurance, and must be truthfully stated in order that the insurer may know whether the liability he is asked to assume be extra-hazardous or not.[1]

§ 70. **Affirmative Warranties classified.** — Affirmative warranties may be classified as follows:

(A) Warranty as to personal and business history of the "risk."

(B) Warranty as to financial status of the "risk."

(C) Warranty as to previous application for policies of

[1] See Seaton *v.* Heath, L. R. 1 App. Cas. for 1899, p. 782.

fidelity insurance, as to whether the same have been required in previous employment.

(D) Warranty as to the absence of defaults of the "risk" when in the previous employ of the insured or of a third party.

(E) Warranty as to the condition of the "risk's" accounts at the time of the insurance policy or of the renewal of the same.

(F) Warranty as to Character of the "risk's" Past or Present Habits and Associations.

§ 71. (A) **Warranty as to the Previous Personal and Business History of the "Risk."**—In view of the fact that the moral element is so prominent in the domain of fidelity insurance, it follows that knowledge as to the previous personal and business history of the proposed "risk" is a matter of no small moment to the insurer. It is necessary for him to carefully weigh all the chances of probable loss as against the premium which is to be received from the insured in case the application and proposal for policy are accepted. The insurer knows that strong home ties of an agreeable nature are strong deterrents against the commission of crime. The insurer also recognizes the fact that other things being equal, the man with a past unblemished reputation is less likely to fall into dishonest ways than the one who has acquired an unsavory reputation in various business connections had from time to time. As a matter of practice married men are generally preferable to single men as "risks" under fidelity insurance policies. Connections with fraternal organizations are regarded favorably by insurers as being likely to conduce towards honesty on the part of the "risk."

For all the foregoing reasons the warranties as to the previous personal and business history of the "risk" are of material value to the insurer more as a means of determining whether to write the policy or not rather than as affording a possible defence to an action on a policy subsequently commenced by the insured thereunder. The reason for this lies largely

in the wording of the insured's statement in respect to these matters, out of which the warranty itself arises. The statement here referred to is usually in the following form:

> "Replies of the applicant for a fidelity insurance policy herein are, to the best of my knowledge and belief, correct. The applicant has always, to the best of my knowledge and belief, given satisfaction in his personal conduct, in the performance of his duties wherever employed, and kept his accounts faithfully and without default. He has not, so far as I know or believe, made any errors or default either in our employment or in any previous service. I know of nothing concerning his habits or antecedents affecting his title to confidence, and I know of no reason why the guaranty policy here applied for should not be granted."

It will be seen from the foregoing wording of the insured's warranty in respect to the matter now before us, that it is made "merely to the best of the insured's knowledge and belief." It is these words, doubtless, so materially limiting the effect of a breach of promissory warranties in regard to the matters covered by them which have led some few of our courts to hold that no act on the part of the insured not amounting to actual fraud or the grossest bad faith is sufficient to avoid the policy on the ground that the same constitutes a breach of warranty.[1] The qualifying words here referred to are said, however, not to affect promissory warranties.[2]

In United States Fidelity and Guaranty Company *v.* Blakely Hurst and Company[3] the insurer interposed a defence that the insured in its application for the policy stated that nothing was known concerning the "risk's" habits affecting his title to confidence, when in fact the latter was engaged in hazardous speculation to the insured's knowledge. The court held that this issue should have been submitted to the jury under special instructions applicable thereto. In this immediate connection it may be said that whenever the duty arises to disclose facts

[1] Guar. Co. of N. A. *v.* Mech. Sav. Bank & Tr. Co., 80 Fed. 766; 26 C. C. A. 146.

[2] Hunt *v.* F. & C. Co. of N. Y., 99 Fed. 242; 36 C. C. A. 496.

[3] 117 Ky. 127; 77 S. W. 709.

to one who has furnished a policy for a designated "risk" at the insured's request, it is only as to facts affecting the "risk" in respect to the subject-matter of his employment, that a direct duty arises to disclose such facts, and subject to this rule the duty does not arise to disclose facts known as to the present habits of the "risk."[1]

Where the defence of failure of warranty as to the previous personal and business history of the "risk" is interposed, it is not necessary that an attempt to defraud by the making of a warranty, not borne out by the facts, should be proved.[2]

§ 72. (B) **Warranty as to the Financial Status of the "Risk."** — One of the determining factors which controls the insurer in passing upon the question whether to accept or decline the application for a policy is that of the proposed "risk's" financial condition. In deciding upon what premium, if any, to accept on application for a policy, the insurer in every instance counts upon the chances of obtaining reimbursements from the "risk" in case any liability is insured under the policy issued in his behalf to the insured. The chances for obtaining such reimbursement, of course, are largely dependent upon the financial conditions of the "risk." Therefore, all things being equal, those policies are held in the highest esteem wherein the "risk" is a man of some financial ability. The greater amount of property possessed by the "risk" at the time the policy is issued, the less likely is the insured to have to make good the liability of the "risk" to the insured without being able to recoup himself in a measure at least from the property of the "risk." As in the case of other insurance contracts, it is the financial responsibility of the insurer which affords the real guaranty of the insured; so here it is the solvency, present and continued, of the "risk," which in itself affords at least a possible source of indemnity in case the insurer is compelled to make good its liability under the policy.

[1] Ætna Indemn. Co. *v.* Schroeder, *et al.*, 12 N. D. 110; 95 N. W. 436.

[2] Perpetual Bldg. & Loan Ass. *v.* U. S. Fid. & Guar. Co., 118 Ia. 729; 92 N. W. 686.

§ 73. (C) **Warranty as to Previous Application for Policies of Fidelity Insurance and as to whether the same have been required in Previous Employments.**—The purpose of requiring such warranty as is above referred to is obvious. It aims to secure from the insurer the entire benefit of previous inspection as to the "risk's" character and antecedents on the part of some other guaranty insurance company which has resulted in the latter's declination of the "risk's" application for a policy. The "surety companies" are very conservative in matters of this kind and are usually loth to issue a policy on any "risk" whose application has been theretofore refused by rival concerns. Such a line of conduct as is here referred to is by no means arbitrary or unreasonable, but is based on the assumption, which is usually sound, that the previous application for a policy would not have been refused without there having been some substantial ground for such refusal. Then, too, investigation as to reasons which induced other companies in the same line of business to refuse to issue a policy on this particular "risk" might lead the insurer to act likewise. But in this, as in other connections of a like nature, it is important to remember that to constitute a breach of warranty it is not sufficient that the statement that the applicant had never been refused a policy by other companies be contained in the application of the "risk" alone. To have that effect the representation on which such alleged breach of warranty is predicated must in any event be made with the insured's approval and endorsement.

In an application to a "surety company" for a fidelity insurance policy answers to questions as to the "risk's" having previously made application to another company for the issuance of a similar policy and as to whether the same was refused, etc., are material and vital representations with respect to matters which the defendant had the right to be informed about as affecting the hazard involved in giving the bond. False answers to such questions by the applicant with

knowledge thereof by the party for whose benefit the policy is required renders the same invalid.[1]

§ 74. (D) **Warranty as to the Absence of Defaults of the "Risk" when in the Previous Employ of the Insured or a Third Party.** — The chronic defaulter, for the purpose of becoming a "risk" under a fidelity insurance policy, is *persona non grata* to the insurer. The "surety companies," as a matter of prudence and business policy, invariably decline a "risk" who has been guilty of serious arrears in any previous employment. The reasonableness of this position has never been questioned, either by the courts or the public, so far as we are aware. This matter is a very important one in fidelity insurance, and the effect of concealment in this respect is often a very serious matter so far as the insurer is concerned. A leading case in this connection is Max J. Wrinkler Brokerage Company *v.* Fidelity and Deposit Company of Maryland.[2] The facts therein briefly stated were as follows:

Upon being solicited by a brokerage firm to execute in its favor an indemnity bond to secure it from loss for one year from acts of larceny and embezzlement by a person whom it proposed to take into its employment, a fidelity insurance company forwarded to it for signature a written application for that person accompanied by a number of questions for it to answer, among them the following: "Have you knowledge of any habit of the applicant or any circumstances unfavorable to the issuance of the bond applied for? If so, state particulars. Is there now to your knowledge any shortage due? Has he ever been short to you? Is he in debt to you?" To which questions the applicant truthfully answered, "No." The company then executed a bond, expiring on the first day of April, 1904. Just before the expiration of the bond the company wrote the former, notifying it that the bond was to expire and requested remittance of continuation premium,

[1] Imperial Bldg. & Loan Co. *v.* U. S. Fid. & Guar. Co., 23 Ohio Cir. Ct. 243; see also Finn *v.* Mut. Life Ins. Co., 70 N. J. L. 255; 57 Atl. 438.

[2] 119 La. 735; 44 So. 449.

and asking it to sign a certificate accompanying its notification and forward the same to it when the continuation receipt would be sent to it. The former filled out the certificate which was sent to it, and after signing it, returned it to the company. The continuation receipt was then sent to the firm. It subsequently appeared that the employee was guilty of larceny or embezzlement, apparently during the first year of the bond and apparently during the continuance of the bond after the expiration of the year. The firm claimed that the company was responsible for the losses during both periods. The latter repudiated the claim. The district court and the court of appeals sustained the claim of the firm (the insured) on the ground that the statements made in the continuation certificate were representations and not warranties and under the terms of the policy they did not have the effect of a warranty if honestly answered. This was said by the Supreme Court of the state to be error, and the court held that the insurer was not liable for the loss suffered after the expiration of the first year. The certificate which the insured signed and sent forward certified that "since the issuance of the above bond the employee has faithfully, honestly and punctually accounted to him for all money and property under his control as my employee, has always had proper securities and is not now in default to me." Concerning this statement it was said that whether the statements contained in this certificate be designated as "warranties" or "representations" they are undoubtedly matters upon which the company was to determine the course which it was to pursue as to the future, and as such they must be truthfully answered.

A rule equally strict seems to have been adopted by the Virginia Supreme Court in a recent case. Here the insurer, a fidelity insurance company, by pleas alleged that it had been induced to execute a policy on one Hammer as teller of the insured bank by the positive representations in writing made to it for and in behalf of the bank by its cashier to the effect that Hammer never had been in arrears or default to the bank,

that his books and securities, including cash securities and vouchers, were last examined in December, 1893, by a Committee of the Board of Directors of the bank and found to be correct, and that but for these representations, it would not have executed the policy. It then averred that these representations were false; that Hammer, as teller, was, at the time of these representations, and had been long prior thereto, a defaulter, and largely in arrears to the bank and that the examination of his books and accounts, including cash, securities and vouchers, which were represented to have been made in December, 1893, was not so made, and that if it had been made, his defalcations would have been discovered. Passing upon the merits of the foregoing plea, the court held that these alleged representations were of existing facts, were material and presumably within the peculiar knowledge of the bank and its officers, and constituted an inducement to the guaranty company on which it had a right to rely in executing the bond. It was therefore immaterial whether the insured knew that they were false or honestly believed them to be true. Thus, if a party innocently misrepresents a fact by mistake, the effect is the same on the party who is misled by it as if he who innocently made the misrepresentation knew it to be positively false. The real question in such a case is not what the party making the misrepresentation knew or believed, but was the representation false and the other party misled by it? [1]

In the opinions of the courts presented above, the representations made by the insured were treated (and properly) as warranties and not as representations.

Where they are disposed of by the courts as mere representations, opportunity is then afforded to nullify their effect on grounds more or less specious as the case may be. One of the favorite methods of avoiding the effect of a misrepresentation where the insured is a corporation, is to hold that knowledge

[1] Guar. Co. of N. A. *v.* First Nat. Bank of Lynchburg, 95 Va. 480; 28 S. E. 909; see also U. S. Fid. & Guar. Co. *v.* First Nat. Bank of Dundee, Ill. ; 84 N. E. 670.

of some particular officer or agent of the corporation cannot be imputed in this connection, to the corporation itself. The true rule that should be applied in such cases is, that where an officer or agent of insured corporations makes a misrepresentation, the insured and not the insurer should suffer, on the theory that where one of two innocent parties must suffer, that one should sustain the loss which reposed the confidence. As illustrating the attitude of some of the courts here referred to, attention is called first to the case of American Bonding and Trust Company *v.* S. B. and L. Society,[1] where it was held that where an application for fidelity insurance by a corporation stated that the secretary of the same — who was the "risk" under the policy — derived his authority from the Board of Trustees, knowledge on the part of a single officer, trustee or president of the corporation that the secretary was indebted to it at the time the policy was issued could not be imputed to the corporation without proof that the officers' knowledge had been communicated to the Board, so as to constitute a breach of warranty under the policy, that the secretary was not indebted to the association at the time of the issuance thereof.

Again, in a case brought in the federal courts on a fidelity insurance policy it was claimed by way of defence on the part of the insurer that the "risk" named therein was a defaulter to the insured at the time the policy was issued, and that this fact was known to the insured at the time and concealed from the insurer. It was further claimed that the insured represented to the insurer that the "risk's" accounts had been examined and found correct, when in truth the "risk" was a defaulter at the time the policy was issued, as the insured well knew or could have known by the exercise of diligence. The court in its opinion said:

"The policy refers to certain statements or declarations relative to the duties and accounts of O'Brien, which it recites had been theretofore delivered to the company and constitute and formed the basis

[1] 130 Fed. 737.

of the contract hereinafter expressed. This statement so referred to, and made part of the contract, was in writing. It consisted of a series of questions and answers propounded to Mr. Coleman, the president of the association, and answered by him. Thus the parties put in writing statements and declarations of the plaintiff which were to be treated as the basis of the contract. None of the pleas of the insurer undertake to make issue upon the representations so elicited and made part of the agreement. If that statement involved no misrepresentations or fraudulent concealment, then the contract would not be affected by loose parol statements or by concealment of facts about which no inquiry was made nor by conduct upon which no reliance was placed."[1]

In Ætna Life Insurance Company *v.* American Surety Company[2] the insurer certified that so far as his knowledge went, the "risk" had faithfully performed his duties and that he was not then at the time the policy was issued in arrears or in default. It was also stated that his accounts were last examined June 13, 1884, and found to be correct in every respect. This certificate bore date June 16, and the policy June 15, 1884. As a matter of fact, the "risk" was then in the insured's debt $150 on a draft which he had drawn on the insured in March, 1884, and which it had paid, but had required an explanation and demanded repayment. It was held that the unpaid draft was not arrears or default, within the meaning of the certificate, which referred to collection accounts, and that the insured was not guilty of such laches as would discharge the insurer from liability on the policy for a subsequent defalcation.[3]

The doctrine of the foregoing cases certainly can have no proper application to warranties. As to these their truth is warranted irrespective of the question of knowledge on the part of officers and agents of the insured. And as to these, the knowledge of those actively participating in the management of the insured, is the knowledge of the insured itself.[4]

[1] Sup. Coun. Cath. K. of Am. *v.* F. & C. Co., 63 Fed. 48; 11 C. C. A. 96.

[2] 34 Fed. 291.

[3] See § 72, *post.*

[4] Livington, *et al.* *v.* Fid. & Dep. Co., 76 Ohio 253; 81 N. E. 330.

§ 75. (E) **Warranty as to the Condition of the "Risk's" Accounts at the Time of the Issuance of the Policy or of any Renewal of the Same.** — It is customary to insert in all policies and proposals for policies a specific statement, either directly signed or approved by the insured, to the effect that the "risk's" accounts in the insured's previous employment had keen kept faithfully and without default, and that when last examined or audited by the insured at a certain date named in such application or proposal, all his accounts were verified and examined and found to be correct. The effect of a false statement in connection with the foregoing warranty would be unquestionably to deprive the insured of the benefits of the fidelity bond for which he had paid a substantial premium.

The doctrine stated above is in entire accord with that enunciated by the federal court of appeals for the Fifth Circuit in Monongahela Coal Company *v.* Fidelity and Deposit Company of Maryland.[1] In this case the insured, prior to the renewal of a guaranty insurance policy, gave to the insurer the following certificate:

"To the Fidelity and Deposit Company of Maryland: This is to certify that on the 17th day of March, 1897, the books and accounts of A, in our employ as agent, were examined by us, and we found them correct in every respect, and all moneys handled by him accounted for. He has performed his duties in an acceptable and satisfactory manner, and we know of no reason why the guaranty bond should not be continued. His salary is now commissions and he is employed as agent." (Signed.)

The officers of the insured at the trial admitted that the books had not really been examined as stated in the certificate. At the trial the court, on request, instructed the jury to find for the insurer. The court at that time said:

"The certificate must be taken as true so far as this 'surety company' has a right to take it, as to them, whether as a matter of fact it was false to the knowledge of the insured or not. There was

[1] 94 Fed. 732; 36 C. C. A. 444.

nothing done by the 'surety company' to mislead the insured into giving this certificate. The enclosing of the blank was a mere form, but it was asserted that he should give the certificate if he expected the renewal of the contract of indemnity. Therefore, he chose to give it. It may have been false that he never examined the books, but the indemnity company had a right to take the fact stated as true, and the suggestion that it was a trick of the indemnity company does not count for anything unless it be shown that the insured was led into a condition of things which does not appear by the testimony. It was a voluntary contribution of the insured. He could have declined to send it or said that he would not send it, because he had not examined the books, but when he did say that he had examined the books and found them correct, the indemnity company had the right to take that part to be true, and did take it for true and acted upon it.

"Unquestionably as between the contracting parties the insured is stopped from denying that certificate in law. He cannot be heard to deny it, to screen himself from it in law as between the two contracting parties. Of course, that would cover all antecedent matters. But further the inducement to the surety company to enter into a second contract was a false inducement. That inducement was in the statement of the insured that the books had been examined and found correct. I think there must be a verdict for the indemnity company."

The Canadian rule on this subject appears to be very strict and distinctively in favor of the insurer. It has been held that the representation that the "risk" had never been in arrears or default applies to a time antedating the latter's employment by the insured, and that a misrepresentation amounting to a breach of warranty as to such matter avoids the insurer's liability under the policy.[1] The American rule is no less strict. It may be said without fear of contradiction that not only the true rule, but the prevailing rule in this country is, that where the insured warrants the truth of a statement to the effect that the accounts of a proposed "risk" have been examined by him and found correct, and this statement is made the basis of a proposal for a fidelity bond, that thereupon the validity of the bond is made to depend upon the absolute truth of the warranty. Under such circumstances,

[1] Ottawa Agri. Ins. Co. *v.* Can. Guar. Ins. Co., 30 U. C. C. P. 360.

any competent evidence showing that the proposed "risk" was in arrears or a defaulter at the time such accounts were examined, will be effective to relieve the insurer from liability under such bond.[1]

Thus where at the time the fidelity insurance contract was executed, the employee whose fidelity was insured was a defaulter to a large amount, and a proper examination of his accounts would have disclosed the fact, it was held that no recovery could be had against the insurer who entered into the contract, relying on the employer's statement that his accounts had been examined and found correct.[2] In this case the court spoke as follows:

"The statements made by the plaintiff were as follows: 'He (Sutherland) has always to the best of my knowledge and belief given satisfaction in his personal conduct and performance of duties and kept his accounts faithfully and without default. When last examined or audited by me on the 31st day of October, 1900, all the accounts of his office were found in every respect correct up to October 31, 1900. He has not been, nor is he at present, so far as I know or believe, in arrears or default. I know of nothing concerning his habits or investments affecting his title to confidence, and I know of no reason why the guarantee applied for should not be granted.'

"Manifestly the plaintiff's statement that he had examined Sutherland's accounts on October 31, 1900, a week before the date of the defendant's bond, and found them correct in every respect up to that date was material to the defendant's undertaking. It bore directly upon the nature and extent of the risk which the defendant agreed to bear, and if in fact this representation was false, whether intentionally or from honest mistake on the part of the plaintiff, it plainly increased the risk, and the plaintiff could not hold the defendant to the agreement which it had made upon the faith of its statement among others."

Written statements made by a corporation accompanying an application to a bonding company for a bond guaranteeing

[1] So held in Issaquah Coal Co. *v.* U. S. Fid. & Guar. Co., 126 Fed. 89; Guthrie Nat. Bank *v.* Fid. & Dep. Co., 14 Okla. 636; 79 Pac. 102; Am. Bond. & Tr. Co. *v.* Burke, *et al.*, 36 Col. 49; 85 Pac. 692; Glidden *v.* U. S. Fid. & Guar. Co., Mass. ; 84 N. E. 143; Carstairs *v.* Am. Bond. & Tr. Co., 116 Fed. 449.

[2] Glidden *v.* U. S. Fid. & Guar. Co., Mass. ; 84 N. E. 143.

the dishonesty of employees, which statements relate to the past conduct of such employees in their service as such, and which intend to and do enter into the contract and become the inducement in part for the issue of the bond, are in the nature of warranties, and their falsity in any material particular will defeat recovery on the bond for the delinquency of such employees.[1]

A possible ground for avoiding the otherwise fatal result of a breach of warranty relative to the correctness of the "risk's" accounts at the time the fidelity bond is applied for, is to hold that where the representation (which is made a warranty by the terms of the bond) is made in qualifying terms, then it ceases to be an absolute warranty. Thus, for example, where it is made in some such language as this: "Not to the knowledge of the insured"; or "to the best of the insured's knowledge and belief," it has been held by at least one court, that such language will avoid the customary fatal effect of a breach of warranty.[2] In the case of the warranty now under consideration, the question as to whether knowledge of the existence of a shortage in the proposed "risk's" accounts, possessed by an officer or agent of the insured — when a corporation — can be imputed to the corporation itself, has no proper application whatsoever. The moment such representations become transformed by proper language into warranties, the question ceases to be one as to whether the insured had any knowledge of a shortage in the proposed "risk's" accounts, and resolves itself into the single inquiry whether or not a shortage in such accounts did exist at the time the warranty relating thereto was made.[3]

§ 76. (F) **Warranty as to Character of the "Risk's" Past or Present Habits and Associations.** — Negative answers by

[1] Livingston, *et al.* *v.* Fid. & Dep. Co. of Md., 76 Ohio 253; 81 N. E. 330.

[2] Am. Bond. & Tr. Co. *v.* S. B. & L. Soc., 130 Fed. 737; see also Hunt *v.* F. & C. Co., 99 Fed. 242; 39 C. C. A. 496; Max J. Wrinkler Brok. Co. *v.* Fid. & Dep. Co., 119 La. 155; 44 Sou. 449; Ætna Indemn. Co. *v.* Schroeder, *et al.*, 12 N. E. 110; 95 N. W. 436.

[3] See *ante*, § 74 and cases cited.

the president of a bank (the insured) to the questions in a statement or declaration in reliance on which the insurer had executed a bond insuring the bank against defalcations by its cashier: "Have you known or heard anything unfavorable as to habits or associations, past or present," or "of any matters concerning him about which you deem it advisable to make inquiry," when he had heard that such employee had been speculating, will defeat any recovery on such bond which provided that any misstatement of any material fact in the declaration should invalidate it.[1] In the case here referred to the court spoke as follows:

"It also results that there can be no recovery at all on the cashier's bond. If the bank had observed the stipulation in the teller's bond to which we have referred, it is obvious that there would have been no cashier's bond and the question would not have arisen. But this it did not do, and the bond was given. The bond provided that the company covenanted with the bank in reliance on the statement and declaration of the president on behalf of the bank, and on the bank's strict observance of the contract; that any misstatement of a material fact in the declaration should invalidate the bond; that the bank should use 'all due and customary diligence in the supervision of said employee for the prevention of default'; 'that any written answers or statements made by or on behalf of said employer in regard to or in connection with the conduct, duties, accounts or methods or supervision of the said employee, delivered to the company, either prior to the issue of this bond or to any renewal thereof, or at any time during its currency, shall be held to be a warranty thereof, and form a basis of this guarantee, or of its continuance.'

"Two of the questions and answers in the declaration were as follows: —

"'*Q.* Have you known or heard anything unfavorable as to his habits or associations, past or present?'

"'*A.* No.'

"'*Q.* Or of any matters concerning him about which you deem it advisable for the company to make inquiry?'

"'*A.* No.'

"In Pauly's case the president and the cashier were confederates in the dishonesty of the cashier, for the purpose of defrauding the

[1] Guar. Co. of N. A. *v.* Mech. Sav. Bank & Tr. Co., 183 U. S. 402; 46 L. E. 253.

bank; and also it was held no part of the duties of the president under the circumstances there disclosed to certify to the integrity of the cashier as he did. In this case the dishonesty was that of the cashier alone; the statements were required to be and were made on behalf of the bank, and the president acted for the bank in so doing, and the bonds were procured by the bank, and the bank paid the premiums. There can be no doubt that the bank was responsible for the representations of its cashier in the one instance and its president in the other in procuring these contracts of indemnity. The representations made in the declaration on which the cashier's bond was issued were clearly misrepresentations. The teller's bond required notification if the bank were informed of speculation on Schardt's part. The president had heard of such speculation and knew that speculation was unfavorable as to Schardt's habits; and the president of course knew that the matters concerning him of which he had heard were such as it were advisable for the company to make inquiry about. True, the second question was, if he had heard of matters about which he deemed it advisable for the company to inquire, and the word 'deem' might be said to give a considerable discretion, but it was not a discretion to be abused. That the company would consider it advisable to make inquiry is too plain for argument, the whole tenor of the bond renders any other conclusion impossible.

"We cannot regard the representations of the president as consistent with good faith, and he was not even called as a witness by the bank to explain his conduct if he could have done so." [1]

§ 77. **Promissory Warranties Classified.** — Inasmuch as the liability of the insurer in fidelity insurance is a continuing one, and measured by the life of the policy, it follows that all warranties which look for their performance to the future rather than to the past are likewise continuing. These, as has already been observed, are called promissory warranties.[2] Ordinarily such warranties are found, not in the body of the policy itself, but solely in the proposal or application. The principal promissory warranties there found may be classified as follows:

(A) Warranty as to amount of additional security required of the "risk" during the period of liability under the policy.

[1] See also Ætna Indemn. Co. *v.* Schroeder, *et al.*, 12 N. D. 110; 95 N. W. 436.

[2] See Regina *v.* Regina Nat. Ins. Co., 13 Guar. Co., 22 S. A. L. R. 5.

(B) Warranty as to the salary of the "risk"; manner of payment of the same.

(C) Warranty as to the nature of the "risk's" duties and powers.

(D) Warranty as to the responsibility of the "risk."

(E) Warranty as to the method of conducting the business of the insured in so far as it may concern the "risk."

(F) Warranty as to the number and duties of the assistants of the "risk."

(G) Warranty to the manner, time and method of checking the "risk's" accounts.

(H) Warranty that all due and customary supervision over the "risk" shall be observed by the insured.

(I) Warranty as to the "risk" having other business than that of his employment with the insured.

§ 78. (A) **Warranty as to Additional Security required of the "Risk" during the Period of Liability under the Policy.** — The purposes of the insurer in requiring the insured to state in the proposal what additional security, if any, will be required of the "risk" during the period of liability under the policy are twofold: first, the information thereby sought may be important in determining whether or not to issue a policy at all; second, the purpose may be found in a desire on the part of the insurer to thereby procure a contingent asset of some material value, which becomes available through the insurer's right of subrogation, either expressed or implied, and which arises on the payment of any loss to the insured under the policy. In other words the insurer seeks in this manner to make it obligatory upon the insured to retain the additional security referred to intact during the life of the policy, so that in cases of the incurrence of liability thereunder, such additional security may become an asset in the hands of the insurer whenever his right of subrogation becomes perfected through payment of loss under the policy to be insured. Whether or not the release of such additional security as had been represented to be held by the insured during the life of

the policy and prior to the occurrence of loss would have the result of relieving the insured from liability *pro tanto* is a question which has not yet been decided, so far as careful investigation shows, by any court in construing a fidelity insurance policy.

When the policy is issued upon the faith of the statements made by the insured that it holds certain additional securities, then this would seem to establish the insurer's right to require that all prior securities remain unchanged during the life of such policy.[1]

In order to release such securities and at the same time not have it affect the liability of the insurer under the policy, the latter's consent to such release must first be secured. But the same rule does not appear to obtain in the case of release by the insurer of securities given it by the "risk" to secure it against loss by reason of the issuance of the policy.[2]

Sometimes the policy expressly provides for notice of other insurance if taken by the insured during the life of the policy. But the failure to give such notice by the insured does not constitute a breach of the warranty so as to avoid the policy.[3] In any event, when other insurance is held by the insured at the time the policy is issued, and this fact is known to the insurer at that time, then the existence of such other insurance does not serve to avoid liability under the later policy, even where this latter expressly prohibits it.[4]

The rule in this connection would seem to be that the insurer is discharged (either wholly or *pro tanto* according to circumstances) when by the act of the insured any rights of subrogation in reference to securities held by the insured at the time the representations were made have been lost or impaired.[5]

[1] See Bank of Monroe *v.* Gifford, 44 N. W. 558; 79 Ia. 300; but see Bank of Tarboro *v.* Fid. & Dep. Co., 128 N. C. 366; 38 S. E. 908.

[2] See Fertig, *et al.* *v.* Henne, 47 Atl. (Penn.) 840.

[3] F. & C. Co. of N. Y. *v.* Carter, 57 S. W. 315 (Tex. App.).

[4] Western Assur. Co. of Toronto *v.* Phelps, 27 Sou. 745 (Miss.)

[5] Mut. Bldg. & Home Ass. *v.* Fid. &. Dep. Co., 23 Sou. 405; 50 La. 291; see *post*, § 133.

§ 79. (B) **Warranty as to the Salary of the "Risk" and Manner of Payment of the Same.** — There is usually a statement in the proposal as to the amount of salary to be paid the "risk," together with the manner of payment of the same. In connection with this there is usually found in the body of the policy itself a provision "that the remuneration of the 'risk,' except as to increase thereof, shall remain and continue during the life of the policy as set forth in said proposal." It may be said, generally, that the amount of remuneration to be paid the "risk" by the insured is an element of considerable importance in determining whether or not a proposal for a policy shall be acted upon favorably on the part of the insurer. Still, again, it is a matter of importance to the insurer to have a "risk's" remuneration paid him in such a manner as to leave no question as to the relationship that exists between the "risk" and the insurer; as, for example, a change from a fixed salary to be paid to the "risk" by the insurer to a remuneration based upon the profits of a business conducted by the "risk" for the insured. For this last might give to the former the rights of a partner, and thus transform what under the former arrangements might have been a criminal act into a mere civil liability. Under the old-time private bonds a change in either the amount of the remuneration or mode of payment of the same frequently had the effect of relieving the surety from liability.[1]

In a recent case an application to a surety company was made for a bond, in which it was stated, in answer to a question as to the salary or compensation to be paid by the insured to the "risk," that the latter was to receive $85 per month as salary or commission. The actual facts in the case were that the "risk" was to receive $10 a week and the use of a flat worth $20 a month and $2\frac{1}{2}$ per cent for collecting rentals amounting to about $1000 a month. The court held that the answer did not invalidate the policy and constituted a valid statement of

[1] See Mut. Bldg. & Home Ass. *v.* Fid. & Dep. Co. of Md., 23 Sou. 405; 50 La. 291.

the "risk's" earnings and was not deceptive or fraudulent.[1] A New York case (involving, it is true, the case of a gratuitous surety) presents a different rule and one which commends itself as more consonant with legal principles. It is that of American Casualty Company *v.* Green.[2] The facts in this case, briefly stated, were as follows:

The plaintiff, a sick-benefit insurance company, made a written agreement with an agent whereby he was to pay all expenses and insurance claims in his district and ten per cent on gross premiums to plaintiff, which agreement was not to go into effect until the agent furnished a bond and defendant signed the bond as surety, and with knowledge of the written agreement. When the bond was delivered, plaintiff and the agent, without the knowledge of defendant, entered into a new agreement whereby the agent was to deduct weekly living expenses from his receipts and to remit the balance thereof, excepting subagent's commissions, to plaintiff, who was to pay all insurance claims and doctors' bills and rent from its home office. It was held, that the new agreement was such an alteration of the written agreement as would release defendant from his obligation as surety.

Plaintiff and the agent having operated under the new agreement until the agent had become indebted to plaintiff, the abandonment of the new agreement and the continuation of the business according to the terms of the original agreement did not suffice to renew defendant's obligation.[3]

§ 80. (C) **Warranty as to the Nature of the "Risk's" Duties and Powers.** — To a large extent the scope of the insurer's liability is dependent upon and controlled by the statements in the proposal and application for a policy with respect to the nature of the powers and duties of the "risk," wherein it is agreed that they shall remain and continue during the entire life of the policy as set forth in such proposal and application.

[1] City Tr., Safe Dep. & Sur. Co. *v.* Lee, Ill. ; 68 N. E. 485.

[2] 75 N. Y. Sup. 407; 70 App. Div. 267.

[3] See *post*, § 90.

It needs but little elaboration to show the importance of the warranty here referred to. The chances of liability for the insurer under the proposed policy depend largely upon the nature of the "risk's" duties and the authority which he will have while performing such duties. A case which commends itself in every way as setting forth the proper application and extent of the warranty now under consideration is that of Issaquah Coal Company *v.* United States Fidelity and Guaranty Company.[1] The essential facts in this case may be briefly stated as follows:

The Board of Directors of plaintiff corporation (the insured), whose meetings were held in New York, passed a resolution requiring the general manager and the assistant treasurer (both of whom were in the state of Washington, where the business of the company was conducted) to procure fidelity bonds at the expense of the company, and they were so procured,—that of the assistant treasurer being issued on a statement signed in the name of the company by the general manager as such, and which was referred to in the bond as having been furnished by the plaintiff, and as one of the inducements for the execution of the bond. At the expiration of the term, requests for further statements or certificates from the insured were sent to the officer of the insured, which were filled out by the auditor of the company, under its name and returned. Thereupon renewal certificates were issued. Certain representations were made as to the duties of the "risk" and these were made warranties. The court held that if, in fact, an officer of a corporation whose fidelity is insured sustains other relations to the company than those indicated in its statement on which the bond was executed, and which was essentially different, and involved the receiving and expenditure of the employer's money, a failure to disclose such relations at the time the bond was issued is a defence to liability of the insurer on its bond.

In this same case the court instructed the jury as follows:

[1] 126 Fed. 89.

"The court instructs you that defendant in this action, by its written application in evidence, undertook to guarantee the fidelity of Mr. Bell as secretary and assistant treasurer, but did not undertake to guarantee his fidelity in any other capacity, and if Mr. Bell sustained any other relation to the plaintiff, a failure to disclose such relation would relieve the insurer from liability on its bond; and if you find from the evidence in this action that at the time the bond in question was written Mr. Bell was sales agent of the plaintiff as well as the secretary and assistant treasurer, then I instruct you that it was the duty of the plaintiff to disclose that fact to this defendant, and if you find that Mr. Bell's position was to the effect of his having been a sales agent, or to his duties or responsibility in such a way as to increase the obligation of this defendant upon its bond, then I instruct you, that, as a matter of law, this defendant is released, and your verdict should be in its favor."

Commenting on this instruction, the appellate court spoke as follows:

"This instruction was based upon the contention of the plaintiff in error that the original statement made by Power on behalf of the corporation concerning the office and duties of Bell was false in that it failed to show that Bell in addition to holding the offices of secretary and assistant treasurer was also a salesman for the company, and in that capacity received and expended considerable sums of money. The employer's statement to the defendant in error contained no reference to his duties as a salesman. It was shown in the evidence that he was such salesman and that he had sold coal for the railroads, steamboats and steamships, and to manufacturing plants and sold coal locally; that sales were made largely on his personal efforts and with the assistance of others whom he engaged for that purpose, and that his average monthly expenses for selling coal were about $300 a month which he spent upon the streets and in the neighborhood of Seattle in his efforts to procure sales of coal. Plaintiff in error contends that the charge was not justified by the pleadings, but the record shows that the evidence was introduced without objection, and that the point that it was not warranted by the pleadings is made for the first time in court. We think the objection comes too late. Nor do we find error in the instruction. If in fact the officer, whose fidelity was insured, sustained other relations to the company than those indicated in the employer's statement — relations essentially different from those that were indicated, and which involved the re-

ceipt and expenditure of the company's money, the insurer was entitled to be informed thereof." [1]

Of course if the bond authorizes the insured to change the position of the "risk" and thus by inplication authorizes the performance of duties different from those set forth in the proposal, then a change of duties would not constitute a breach of the warranty under consideration.[2]

It is probable that a mere temporary assignment of a "risk" to duties different from those set forth in the application, would not have the effect in law of relieving the insurer entirely from liability.[3] It would, however, have the effect undoubtedly of relieving the insurer from any liability for loss occurring in connection with the "risk's" performance of such temporary duties.

It may be said that the question as to the scope of the "risk's" authority is ordinarily a mixed question of law and fact. In a Pennsylvania case the insurer claimed that it was for the court, in the first instance, to determine as a matter of law whether or not the insured's loss was covered by the policy issued by the insurer. On this point the court said:

"The counsel for the insured urges most strongly that the duties imposed upon the 'risk' were conferred by the by-laws of the insured association, and that he had only such duties in the way of supervision and general management of the business of the corporation as were incident to that position, and that he had nothing to do with the financial operations of the corporation, and that all matters relating thereto were covered by the duties of the treasurer. It is claimed that the contract between the parties shows such to be his duties, and that

[1] See to the same effect: Livingston, *et al.* *v.* Fid. & Dep. Co., 76 Ohio 253; 81 N. E. 330; Tradesmen's Nat. Bank *v.* Nat. Sur. Co., 169 N. Y. 563; 62 N. E. 670; Sun Life Ins. Co. *v.* U. S. Fid. & Guar. Co., 130 N. C. 129; 40 S. E. 975; U. S. Fid. & Guar. Co. *v.* Ridgley 70 Neb. 622; Engler *v.* People's Fire Ins. Co., 46 Md. 322.

[2] Champion Ice & Cold Storage Co. *v.* Am. Bond. & Tr. Co., 115 Ky. 863; 75 S. W. 197; see also T. M. St. Clair & Co., Ltd. *v.* Nat. Sur. Co., 132 Ia. 549; 107 N. W. 184; City Tr., Safe Dep. & Sur. Co. *v.* Lee, Ill. ; 68 N. E. 485; F. & C. Co. *v.* Gate City Nat. Bank, 97 Ga. 634; 25 S. E. 392.

[3] On this point see Dime Sav. Bank *v.* Zeigler, 49 Mich. 157.

it should have been so construed by the court, and the question as to his duties should not have been submitted to the jury. We cannot agree with the learned counsel. It is true, as he suggests, that the liability of a surety is not to be extended by implication beyond the terms of his contract and that any material alteration therefrom may discharge the surety. Ferris, the 'risk,' was appointed general manager of the association, and as such gave bond to secure his employer against any fraud or dishonesty in the performance of the duties of his position. But what were those duties? They were not specifically defined in the contract itself, so that the court could, as a matter of law, ascertain and determine them. This, then, became the duty of the jury under the evidence of the case."[1]

In this same case it was held that parol evidence as to the duties of the "risk" and as to the amount of money received and embezzled by him is admissible. This on the theory that it amounted simply to showing that the duties of the "risk" were the receipt and temporary custody of the funds of the insured. The court remarked that such "testimony in no way changed or enlarged the liability of the insurer to the insured; nor did it show any duties or responsibilities different from those set forth in the statement of the insured's president, on the faith of which the policy was issued, or different from those prescribed in the by-laws." There seems to be no valid reason why the rule applied in the case of alleged liabilities under policies covering persons occupying positions of public trust should not be held equally applicable to private "risks." That is, that the question of the insurer's liability should depend very largely upon the determination of the question as to whether the "risk" was acting within the scope of his employment as designated in the application or proposal, when the loss occurred, for which it is sought to make the insurer liable.

§ 81. (D) **Warranty as to Responsibility of the "Risk."** — The warranty just referred to is in many respects analogous to the one which has just preceded it. It has reference more particularly to the extent in a pecuniary sense of the oppor-

[1] H. S. & L. Ass. *v.* U. S. Fid. & Dep. Co., 197 Pa. 177; 46 Atl. 910.

tunity for dishonesty, which shall be afforded the "risk" by reason of the responsibilities of his position rather than by reason of his holding any specific position, considered separate and apart from the responsibilities thereby involved. The questions contained in the proposal and application are so framed as to bring out fully and in great particularity the responsibilities of the "risk" while in the employ of the insured.

The true rule applicable to cases where there has been a breach of warranty as to the responsibilities of the "risk" is well set forth in Sun Life Insurance Company *v.* United States Fidelity and Guaranty Company.[1] Here an insurance company employed a person as assistant superintendent of the thrift department in connection with its Wilmington agency. His duties were to procure agents to canvass and collect for the company. In January the defendant company insured the employer against loss by larceny or embezzlement by his employee. Later on in April a new contract was made with the employer in which he was designated as district "manager" and "agent" and his field of operations made to embrace these accounts. The contract further provided that all agreements previously made should be abrogated and that the employee should furnish a bond with two sureties. The first contract required a bond with only one surety. The court held that the April contract increased the business and territory in which the "risk" operated and thereby discharged the insurer from liability.[2]

In United States Fidelity Company *v.* Ridgley[3] it was specifically held that statements made by the employer in support of his employee's application for a fidelity bond, as to the nature of the duties of such employee, the extent of his authority, etc., were in the nature of a warranty and that a breach thereof would have the effect of relieving the insurer on the bond.[4]

[1] 130 N. C. 129; 40 S. E. 975.

[2] See to the same effect Issaquah Coal Co. *v.* U. S. Fid. & Guar. Co., 126 Fed. 89.

[3] 70 Neb. 622; 97 N. W. 836.

[4] See to the same effect Issaquah Coal Co. *v.* U. S. Fid. & Guar. Co., 126 Fed. 89.

Attention is next called to the case of Tradesmen's National Bank *v.* National Surety Company.[1] Here a fidelity bond was given by an agent, for the faithful performance of his duty to account for property delivered to him and to assign invoices for sales thereof. It further provided that the insured should deliver bills of lading to the "risk" only in trust to act as agent for the purpose of receiving and making a sale of the property represented thereby, and that invoices of the sales should be immediately assigned to the insured. The court held that such a provision imported that the proceeds of the sales would be collected from the purchasers by the insured, and its act in subsequently authorizing the "risk" to hold the property in trust for the purpose of selling it, upon his promise that he would deliver the proceeds of the sales within a fixed time, was such an enlargement of the liability assumed by the insurer under the bond as would, in case of a breach, release it from liability thereon.

In the case of Harrisburg Savings and Loan Association *v.* United States Fidelity and Guaranty Company[2] a fidelity policy was issued which provided that it should secure the "risk's" honesty in the performance of his duties in the position of general manager of the plaintiff's association. It guaranteed the insured against loss by any act of fraud or dishonesty on the part of said "risk" in connection with the duties of his said office.

It was held that the receipt and temporary custody of moneys of an association by the general manager was contemplated as one of his duties, where a policy had been given to secure his honesty in the performance of his duties as such manager. The court permitted evidence to be offered, showing it to be one of the duties performed by him with the ratification and approval of the board of directors of the insured, in the course of which he embezzled the money. The "risk" in his application for the policy had stated as to the

[1] 169 N. Y. 563; 62 N. E. 670.
[2] 197 Pa. St. 177; 46 Atl. Rep. 910.

nature and duties of his position, that such duties were set forth in the by-laws of the association; that his position was partly clerical in character, no executive powers being vested in him; that itemized reports were made to the directory at each meeting of all cash received in office; that moneys received in payment of dues were deposited in bank each day, and did not exceed $500 and $600 at a time; that a complete system of credit slips was used, the books were subject to inspection by the inspectors at all times, and periodical examinations of all accounts were made by the state banking department; and that said by-laws declared it the duty of the manager subject to the direction of the directors to have supervision of the affairs of the association, and that he should perform such duties in the detail work of the association as prescribed from time to time by the board of directors.

The defence was specifically interposed by the insurer that the duties of the general manager had been changed and enlarged subsequent to the execution of the policy, and that the loss sustained by the insured did not occur while the "risk" was in the performance of his duties as general manager, and therefore was not covered by the policy. Commenting on this fact, the court spoke as follows:

"The insurer requested the trial court to charge that if the jury believed that the duties and responsibilities of the 'risk' were enlarged after the execution of the policy by permitting him to receive moneys, which under the by-laws should have been paid to the treasurer, an entirely different office with different duties and greater responsibilities, — and no notice of such enlargement of duties and responsibilities was given to the insurer, it was such a variance of the terms of the policy as would discharge the latter from liability under the policy. The learned court below very properly, as we think, submitted to the jury to determine whether the receipt of the money of the association was a part of the duties of the 'risk' as understood by the parties when the insurer entered into a contract of suretyship, with the instruction that if it was, the insured could recover; but if it was not, there could be no recovery. The practical effect of the insurer's request in the point under consideration was, that if subsequent to the execution of the policy, other duties were imposed upon

the 'risk' than those contemplated in his contract, the defendant was not responsible for his defalcation, regardless of the question, whether the money was embezzled while the 'risk' was in charge of such additional duties or not. But if the moneys embezzled were received by him under the appointment and in pursuance of his duties, the faithful performance of which was secured by the policy, the mere fact of the imposition upon him of other greater duties and responsibilities in no way interfering or modifying those imposed by his original appointment would not discharge the surety."[1]

§ 82. (E) **Warranty as to the Method of conducting the Business of the Insured in so far as it may concern the "Risk."** — The foregoing warranty is closely related to that which has reference to the mode of supervision by the insured of the "risk's" accounts. It, however, has no reference to specific methods for checking accounts at regular intervals, but has reference more particularly to the standard of excellence maintained by the insured in the general conduct of its business. Such warranties tend to show the presence or absence of modern business methods as well as the general opportunities to be found thereunder for the commission of acts of fraud and dishonesty on the part of the "risk." The policy usually specifically provides that the manner of conducting the business of the insured shall remain during the entire life of the policy as set forth in the proposal.[2]

Sometimes in an attempt to make the warranties in the proposal of more practical benefit to the insurer than what they otherwise might be, a provision is inserted in the policy requiring the insured specifically to observe and enforce all rules and regulations which may now, or may be at any time

[1] See *post*, § 90.

[2] See Ætna L. Ins. Co. *v.* Am. Sur. Co., 34 Fed. 291; Harbor Commissioners *v.* Guar. Co., 22 Sup. Ct. Rep. (Can.) 542; Molson's Bank *v.* Guar. Co. of N. A., Mont. L. Rep., 4 Sup. Ct. Rep. 376; Haworth *v.* Sickness & Acc. Assur. Ass., 28 Sc. L. Rep. 394; Globe Sur. & Lia. Co. *v.* Emp. Lia. Assur. Co., 13 Manitoba, L. R. 531; Board of Education *v.* Cit. Ins. Co., 30 U. C. C. P. 132; Protestant Board *v.* Guar. Co. of N. A., 31 L. Can. J. 186; European Assur. Soc. *v.* Bank, 7 Rev. Leg. 57; 14 L. Can. J. 186; Ward *v.* Law Prop. Assur. Soc., 4 W. R. 605.

made for the guidance and well ordering of the "risk" in his duties, or for the prevention and detection of default.

A case in point in this connection is that of Rice *v.* Fidelity and Deposit Company.[1] Here a policy had been issued by the Fidelity and Deposit Company to the insured, upon one Perry, who was in the latter's employ. Perry was guilty of illegally drawing out funds from the bank account of his employer for his own use, without their knowledge. Suit was brought on the policy on account of such withdrawals by Perry, and the insurer pleaded as a defence to such suit that the insured had agreed with it that all checks drawn by Perry on the insured's bank account during the life of the policy should be countersigned by their bookkeeper, and that they had entirely failed to keep this stipulation of the contract. There was a trial of this issue and a verdict and judgment for the insurer. On appeal the court discussed the legal question thus presented at the trial, as follows: "The first complaint which counsel urge against the action of the court below upon the trial is that it received in evidence, over their objection, a certain written instrument signed by Rice Bros. and Nixon (the insured) and dated August 30, 1895, to the effect that the countersignature of John W. Gribble (the bookkeeper) would be invariably required on all checks drawn by Perry in their behalf, and that the court charged the jury that if they believed this instrument was made and delivered to the company before the bond was delivered, and that the plaintiffs permitted Perry to draw checks on their behalf without the countersignature of Gribble, these facts constituted a complete defence to the action. The argument of counsel is that these rulings were erroneous because the statement in the written instrument that the checks drawn by Perry should be countersigned by Gribble was a representation, and not a warranty, and hence a failure to comply with it constituted no defence to the action, unless the statement was not only false, but fraudulent, and material to the risk,

[1] 103 Fed. 427; 43 C. C. A. 270.

and because the proof was that this instrument was not made or delivered until the bond had been delivered, and there was no evidence to the contrary. For the purpose of the determination of the question presented by this argument, the evidence of the plaintiffs in error will be considered to be true, and the claims of their counsel relative to the facts of this case will be assumed to be well founded. Under this concession and assumption, these are the facts material to the issues now under discussion.

"Before the bond upon which this action is founded was delivered to the obligees, and before it became effective, the company requested them to answer in writing several questions, and they did so. Two of those questions, together with the contract at the foot of the instruments containing the answers, read in this way:

"'10. (*a*) Will he (the employee, Perry) be authorized to sign checks on your behalf? *Ans.* Yes.

"'(*b*) Will the countersignature of any other person be invariably required? If so, whose? *Ans.* No.

"'It is agreed that the above answers are to be taken as conditions precedent, and as the basis of the said bond applied for, or any renewal or continuation of the same that may be issued by the Fidelity and Deposit Company of Maryland, to the undersigned upon the person above named.'

"This instrument was dated August 9, 1895, and was signed by the plaintiffs in error. After the bond had been made and delivered, the company again requested answers in writing to the same questions, and in response to that request the plaintiffs in error made the following answers, and signed and delivered to the company the instrument dated August 30, 1895, which is the subject of the controversy in hand. That instrument contained the following questions, answers, and contract:

"'10. (*a*) Will he be authorized to sign checks on your behalf? *Ans.* Yes.

"'(*b*) Will the countersignature of any person be invariably required? If so, whose? *Ans.* Yes. John W. Gribble, bookkeeper.

"'This is to certify that the answers herein given to No. 10, *a* and *b* are to be substituted for any other prior statements that have been made by us in relation to the application of Walter J. Perry for a bond in the penalty of ten thousand dollars as manager in our employ at South Omaha, Nebraska. No other statements except No. 10, *a* and

b shall be affected by this certificate. It is agreed that the above answers are to be taken as conditions precedent and as the basis of the said bond applied for, or any renewal or continuation of the same that may be issued by the Fidelity and Deposit Company of Maryland to the undersigned upon the person above named.

"'Dated at Chicago, Illinois, this 30th day of August, 1895.
Signature of employer: RICE BROS. AND NIXON,
By W. H. RICE, Member of Firm.'

"This instrument was delivered to the defendant in error before any of the acts of fraud and dishonesty on account of which this action was brought had been committed by Perry. The bond contains this recital:

"'And whereas the employer has delivered to the Fidelity and Deposit Company of Maryland, a corporation of the state of Maryland, hereinafter called the "Company," a statement in writing relative to the responsibilities, and checks to be used upon the employee in said position, and other matters. Now, then, in consideration of the sum of $100 paid as a premium for the period from July 25, 1895, to July 25, 1896, at twelve o'clock noon, and upon the faith of the said statement as aforesaid, by the employer, it is hereby declared and agreed that the company will indemnify the obligees on certain conditions named in the bond.'

"The first contention to be considered on this state of facts is the claim of counsel that the plaintiffs' statement and agreement contained in the instrument of August 30, 1895, to the effect that the countersignature of Gribble, the bookkeeper, would invariably be required on Perry's checks on their account, and that this statement should be taken as a condition precedent and as the basis of the bond, together with their complete failure to comply with this provision of their contract, constituted no defence to the action because the statement and agreement were representations and were not warranties. The terms 'representations' and 'warranties' are imported in this case from the law of insurance. Under the law on that subject, they generally and properly describe statements of existing facts, not promises or prophecies regarding future acts. In insurance a representation is a statement made by the applicant to the insurer regarding a fact material to the proposed insurance, and it must not only be false, but fraudulent to defeat the policy. Warranty in the law of insurance is a binding agreement that the facts stated by the applicant are true. It is a part of the contract, a condition precedent to a recovery on it, and its falsity in any particular is fatal to an action upon the policy.

"A careful examination of the case in hand disclosed the fact that it has all the attributes of a warranty, and essential characteristics which clearly distinguish it from a representation. A representation is a mere declaration of a statement in fact, but it is neither a condition precedent nor a part of the contract, while a warranty is both. The statement in issue that the countersignature of Gribble will be invariably required on the checks of Perry on the account of the plaintiffs is a part of the contract between the parties to this suit, and a condition precedent to recovery upon it, because the bond recites that it rests upon the faith of this statement, and because the plaintiffs expressly agree in the written instrument of August 30, 1895, that their statement contained therein shall be taken as a condition precedent and as the basis of the bond. This conclusion has not been reached without a careful consideration of the argument of counsel for the plaintiffs in error, that the statement in this instrument is a mere declaration of an unexecuted intention, and that the failure to comply with such a declaration is not fatal to a recovery upon a contract induced by it. . . . The crucial distinction between a representation and a warranty is that the one is not, and the other is, a part of the contract between parties, and that the truth of the one is not, and the truth of the other is, a condition precedent to a recovery upon the policy or bond to which they relate. In the cases cited by the plaintiffs in error which we have been reviewing, there was no agreement of the parties that the declarations which they contained were parts of their contracts, no binding agreement that they should be true, no contract that their truth should constitute a condition precedent to a recovery upon them. In the case at bar the parties expressly agreed in writing that the statement of the employers was a part of their contract; that it should be not only the basis of the bond, but a condition precedent, without compliance with which there could be no recovery upon the obligation. The conclusion is irresistible that under this agreement the declaration in this case was of the nature of a warranty, and not of a representation, and our conclusion is: A written statement made by employers to the obligor in a bond of indemnity against the dishonest acts of their employee to the effect that they will invariably apply certain checks to his action, which the parties expressly agree, by the statement itself and by the bond, shall be the basis of the latter, and a condition precedent to a recovery upon it, is in the nature of a warranty, and not of a representation, and a failure to comply with the promise it contains is fatal to an action upon the bond. . . .

"There are other propositions of law which are fairly applicable to

this contract that lead to the same result. The complaint alleges and the fact was that the plaintiffs made an agreement of employment with Walter J. Perry at the time this bond was made, under which he became liable to them for the losses which they claimed to have sustained through his dishonest and fraudulent acts. The bond of the fidelity company in suit recited this employment, and gave to the plaintiffs further indemnity to the amount of $10,000 against these losses. The legal effect of these contracts was to create the relation of principal and surety between Perry and the fidelity company. The plaintiffs were necessarily aware of this relation. They agreed in so many words by the instrument of August 30, 1895, that the countersignature of their bookkeeper on the checks of Perry against their account should be a condition of a liability of this surety; and the general rule is that if a condition, known to the obligee, upon which a surety agrees to be bound is not complied with, the surety is discharged."

Again, in Harbor Commissioners *v.* Guaranty Company,[1] the facts were as follows: A guaranty policy insuring the honesty of the "risk" had been granted upon the express condition that the answers in the application contained a true statement of the manner in which the business was conducted and accounts kept, and that they would be so kept, and that the insured should immediately upon its becoming known to it give notice to the insurer that the "risk" had become guilty of any criminal offence, entailing or likely to entail loss upon the insured and for which a claim was likely to be made under the policy. There was a defalcation in the "risk's" accounts, and the evidence showed that no proper supervision had been exercised over the "risk's" accounts and the insurer was not notified within a week after the insured had knowledge of the defalcation and after the "risk" had left the country. It was held that as the insured had not exercised the stipulated supervision over the "risk" and had not given immediate notice of the defalcation, he could not recover under the policy.[2]

In Globe Savings and Loan Company *v.* Employers' Liability

[1] 22 Can. Sup. Ct. Rep. 542.

[2] See also Bank of Tarboro *v.* Fid. & Dep. Co., 128 N. C. 366; 38 S. E. 908.

Assurance Corporation [1] it was held that a condition requiring "all reasonable verification of the statements in the proposal and of compliance therewith" was binding and that "compliance therewith" meant subsequent compliance with the indicated course of conducting the business. Where the course of business outlined in the application is incorporated in the policy, then, upon principles of equity, irrespective of whether a warranty is thereby created, the insurer should be discharged by a departure from that course materially contributing to the loss insured against.

An interesting state of facts existed in the case of Tradesmen's National Bank *v.* National Surety Company.[2] Here a bond was given by an agent providing for the faithful performance of his duty to account for property delivered to him and to assign invoices for sale thereof. It further provided that the insured should deliver bills of lading to the "risk" in trust, to act as agent for the purpose of receiving and making a sale of the property represented thereby and that invoices of the sale should be immediately assigned to the insured. The court held that such a provision in the bond imported that the proceeds of the sales should be collected from the purchaser by the insured, and that its act in subsequently authorizing the risk to hold the property in trust for the purpose of selling it, upon his promise that he would deliver the proceeds of the sale within a fixed time, is such an enlargement of the liability assumed by the insurer issuing the bond as would, in case of a breach thereof, release the latter from liability thereon.

Again, attention is called to the case of Phenix Insurance Company *v.* Guarantee Company of North America.[3] An application to a surety company for a bond to secure the faithful performance of his duties by the cashier of the applicant (a corporation) contained the following question and answer:

[1] 13 Manitoba, L. R. 531.

[2] 169 N. Y. 563; 62 N. E. 670.

[3] 115 Fed. 964.

"'Will he receive remittances from customers on accounts? If so, how often will you render customers a statement of the balance due by them, and by whom will this be done? This should be done by some other person than the applicant, and is important as a means of verifying the balances appearing on the ledger.' *Ans.* 'Yes. Monthly by the bookkeeper.'"

It was held that such answer was not a warranty that such monthly statements should be delivered to the customers or deposited in the mail by the bookkeeper personally, but that it was complied with where such statements were made out by the bookkeeper and deposited by him in sealed envelopes in the receptacle used for outgoing mail according to the customary practice of the corporation's business.

Such application also contained the following question and answer:

"'It is suggested (1) that all moneys and checks received be deposited intact in bank and all disbursements be made either by check or from a petty cash fund drawn from the bank as required; and (2) that all checks received be indorsed for deposit to prevent any loss or conversion. To what extent are these provisions to be followed?" *Answer:* 'Fully.'"

It was held that the employer complied with such warranty by adopting a regulation requiring all checks to be deposited, indorsed as therein specified, and by exercising a reasonable supervision over its cashier to see that the practice was pursued; that the answer to such question could not be construed as an absolute warranty by the employer that its cashier would deposit all checks, properly indorsed, and to relieve the surety from liability for the failure to make such deposits contrary to the employer's regulations and without its knowledge, where it exercises reasonable diligence in the premises, which would render the contract nugatory, as one for indemnity. In making this holding the court spoke as follows:

"If the indemnity company cannot be held liable in this case, it never can be held liable in any case. In short, if we give the alleged warranties the scope which the defendant

claims should be given to them, no bond of indemnity would ever be taken out by an employer because he would assume the full burden of watching his employee and relieve the indemnity company of all responsibility." The application and bond in all such cases are to be read together, and they constitute but a single contract.

Further than this, the general rule is that if a condition known to the obligee upon which a surety agrees to be bonded is not complied with, that the surety is discharged.

§ 83. (F) **Warranty as to the Number and Duties of the Assistants of the "Risk."** — In view of the difficulty that sometimes might be met with by the insurer in ascertaining the proximate cause of a loss which is claimed by the insured to have arisen under the policy through the direct fraudulent acts of the "risk," it is important for the insurer to know the number and duties of the latter's assistants in order to rightly estimate the probable chance of loss under the policy. For this reason questions are inserted in the proposal and application having reference to the number and duties of the "risk's" assistants. Such questions are important in that they have a direct bearing upon the extent of the liability which the insured asks the insurer to assume. In explanation of this statement it may be stated that while nearly all policies contain provisions to the effect that the insurer shall be liable "only for the personal acts of the 'risk,'" nevertheless where subordinates are acting under the orders of the "risk," or in collusion with him, in the commission of fraudulent acts, such inquiries as are here referred to have a material bearing upon the question of the extent of the insurer's liability under the proposed policy.[1]

§ 84. (G) **Warranty as to the Manner, Time and Method of Checking the "Risk's" Accounts.** — It is rare indeed when the insured is not required to make some warranties with reference to the manner, time and method of checking the "risk's" accounts. This matter is usually referred to both in the pro-

[1] See Mut. Bldg. & Home Ass. *v.* Fid. & Dep. Co., 23 Sou. 405 (La.).

posal for and in the policy itself. These policies frequently provide that there shall be an inspection or audit of the accounts and books of the "risk" by the cashier at least once in every six months during the life of the policy. The modern doctrine on this subject has been nowhere more clearly set forth than by the United States circuit court of appeals in the case of Hunt *v.* Fidelity and Casualty Company of New York.[1]

Here an action was brought upon a policy of insurance issued by the Fidelity and Casualty Company to the People's Fire Insurance Company indemnifying the latter against any loss that might occur through the embezzlement of one Kingman, its general agent in the city of New York. The policy was issued upon the declaration signed by the insured containing statements in the form of answers to questions relative to the subject-matter of the policy. These statements were by the terms of the policy to constitute an essential part and form the basis of the contract. The declaration also stated that the answers were true to the best of the knowledge and belief of the insured and were to be taken as the basis of the contract between the insurer and the insured. The material statements contained in said declaration were the following: "*Q.* How will moneys reach his (Kingman's) hands? *A.* Paid to him in the course of business for transmission to the company. *Q.* How often and by whom will cash be compared and verified with accounts and vouchers? *A.* Monthly." The court below directed a verdict for the defendant upon the ground that it was established that there had been no monthly examination of the cash and accounts of the agent in compliance with the terms of the insurance. The appellate court in its opinion spoke as follows:

"Reading the several statements of the insured together, it is plain that the statements that the cash would be compared and verified monthly with accounts and vouchers meant that the insured would monthly examine the accounts of its agent and compare and verify

[1] 99 Fed. 242; 39 C. C. A. 496.

them with the cash in his hands, in order to ascertain the correctness of his accounts. Such an examination would have shown what he had received by way of premiums, what he had disbursed by way of expenses, what he had transmitted to his principal and how the balance compared with the moneys on hand. A monthly verification of that character would tend to exercise a salutary check upon the transactions of the agent in dealing with the funds of his employer and might prevent as well as reveal any irregularities or dishonest manipulation on his part. It was, to some extent at least, to have been a safeguard to his employer, and to the insurer who was to become responsible for any defalcation of the agent. Corporations engaged like the insured in the business of fire insurance generally conduct their business in different places by local agents, under the supervision of the general agent. It would seem to be the meaning of the statements that the office of the New York agent of the insured should be subject to this supervision for the purpose of verifying his accounts. But if this is not its meaning, it is at all events a promise that either at the New York office or at its general office or at some other place the insured would attempt to make a monthly examination in order to ascertain if the cash in its agent's hands corresponded to the balance which should be there according to his accounts. Promissory statements having been made a part of the contract between the parties by the terms both of the policy and the declaration, it was in effect a warranty which the insured was bound to fulfil in substance according to its meaning.

"It is quite immaterial that the statement is not called a warranty. It is a stipulation embodied in the contract by the holders of the policy for the performance of future acts and as such is an express warranty.

"Undoubtedly the language of the declaration that the answers were true to the best of the knowledge and belief of the insured qualifies the effect of several of the warranties, restraining them to a breach of such representations as were not honestly made by the insured. Several of the statements were in respect to facts existing at the time and previous, and as to those the insured did not stipulate unconditionally, but the language has no reference to the warranties for subsequent acts, *because as applied to them it would be meaningless.* It appeared at the trial that his promise to examine his agent's cash monthly had not been fulfilled by the insured. The monthly comparison of the checks sent to it by this agent with the accounts and vouchers sent by him two months previously was not a comparison of the cash in his hands with his receipts and disbursements. It was merely a comparison of a part of it, the part which he had transmitted,

and did not involve any examination of his accounts in order to ascertain whether his cash on hand corresponded with the premiums received during the past two months. No attempt was made to ascertain this by the insured. What was done was of no value in comparing the cash actually in the agent's hands with the amount which he ought to have on hand at that time. In ruling that the promises of the insured had not been fulfilled and the defendant was therefore entitled to a verdict the court below was clearly correct."[1]

In the case of Ætna Indemnity Company *v.* J. R. Crowe Coal and Mining Company[2] the surety company averred in its answer to the complaint of the insured in a suit brought against it on a fidelity insurance policy issued by it upon one Graves, its bookkeeper and cashier, that the bond sued on was issued in reliance upon a statement, bearing date February 24, of the insured, made to it at the time the bond was issued, to the effect that the risk should not sign checks without the countersignatures of either the general manager or president of the insured company. It was further averred that the insured breached this warranty by subsequently, during the year covered by the bond, permitting the risk to sign checks without the safeguard agreed upon and warranted to be enforced.

"For the purposes of the present discussion we may assume that proof was offered and given, tending to establish among other things that Graves was permitted to sign checks without any countersignature. The trial court at the request of defendant refused to instruct the jury that the answers contained in the statement of February 24 were warranties, and that if any of them was not true in fact, the contract sued on was void, and refused on like request to instruct that if checks were permitted to be signed by Graves without any countersignatures of the general manager or president, the contract was avoided and errors were duly assigned on the court's action.

"Without referring to other breaches of warranty relied on by defendant founded on the instrument, the foregoing is deemed sufficient to fairly present the legal proposition involved.

"Counsel for plaintiff contend that there is not sufficient evidence

[1] See also Haworth & Co. *v.* Sickness & Acc. Assur. Ass. Lim., 28 Sc. L. Rep. (Sc. Ct. Sess., 1891) 394; Towle *v.* Nat. Guar. Assur. Soc., 7 Jur., N.S., 1109; 30 L. J. Ch. 900.

[2] 154 Fed. 545.

showing or tending to show that the renewal contract sued on was executed by defendant or accepted by plaintiff on the faith of the statement of February 24 and therefore, that any breach of warranty contained in the state, any failure to perform any of its promises, cannot affect plaintiff's right of recovery in this case.

"The contract sued on makes no reference to the statement of February 24. It reads as follows:

"'HARTFORD, CONNECTICUT, June 30, 1903.

"'In consideration of the payment of the sum of $20.00, being the premium for the 3d year upon bond F1774 of the Ætna Indemnity Company for $5000 issued June 1, 1901, in behalf of David C. Graves, in favor of J. R. Crowe Coal Company, Kansas City, Missouri, said bond is hereby continued to June 1, 1904, subject to all the covenants and conditions thereof. . . .

Signed, CHAS. LINDLEY, Pres.,
E. S. PEGRAM, Sec.'

"The plain and unambiguous language of the contract just quoted shows that what the parties apparently did was to continue in force for a third year the original contract known as bond F1774, 'subject to all the covenants and conditions thereof,' and by fair and reasonable intendment not subject to the terms and conditions of any other instrument. The original bond, F1774, was a renewal instrument, containing many terms, covenants and stipulations of the parties and filled with many conditions of defeasance of one kind or another. To all of these terms, covenants and stipulations and conditions the plaintiff clearly became bounded and in violation of any of them might *ipso facto* have defeated recovery on the contract as written. In the face of such affirmative reference to the terms and conditions of one instrument, and in the light of the accepted maxim, '*expressio unius exclusio alterius*' it requires very clear proof that the parties intended to contract without reference to any other instrument containing other terms or conditions.

"Turning now to the statement of February 24, we perceive nothing in the terms employed or in any implications suggested to indicate an intention to make the statement the basis or consideration for any renewal of the old bond. The request by defendant's security to answer questions propounded found at the beginning of the statement was made in connection with the representation that Graves had just made an application to defendant for an indemnity bond which

required immediate action by defendant. The general scheme of the statement and the language used indicated that the bond contemplated was a new one just applied for by Graves, and one which should be dated February 1, 1903, and should run to February 15, 1904. By the last clause of the statement the answers made by plaintiff were agreed to be taken as conditions precedent to and as a basis of the execution of such indemnity bond; that is, the bond to run from February 1, 1903, to February 15, 1904. No intimation can be found indicating in the slightest degree that the parties intended the answers to the questions to be conditions precedent to or to form the basis of the execution of any other bond whatsoever, and certainly not of the renewal bond F1774. The application and statement of February 24 seems to have been intended for the purpose of originating a new contract — certainly some contract other than the renewal of the old one of 1901. The parties were competent to contract and had it in their power either to renew the old or make a new contract. They determined to renew the old one because they did it; and the application of Graves for a new one to date February 1, 1903, and running to February 15, 1904, was not accepted because no such contract as that application contemplated was ever made. Accordingly the agreement found at the end of the statement making the answers to questions propounded in which warranties or conditions precedent to the validity of the bond, has no application in this case. Parties have an undoubted right to make their own contracts, and when they are reduced to writing in plain and unambiguous language, they must stand as written and be enforced accordingly. It does not follow that because plaintiff proposed to defendant or was willing to make the truth of certain statements a condition precedent to liability on one proposed contract it intended to make those statements conditions of liability, if some other and different contract should be afterwards made by the parties.

"But it is contended that outside of the language employed by the parties in the written instrument, they agreed by correspondence that the warranties contained in the statement of February 24 should be conditions precedent to the validity of the contract, renewing the old bond, F1774. We find no such agreement in correspondence between defendant and plaintiff. Many letters passed between defendant and its local agents in Kansas City about the advisability of having an employer's statement different from that obtained from plaintiff prior to the execution of the original contract and of the necessity of having a different statement made before any further renewal should be granted. An effort was made to so connect the local

agents with plaintiff as to raise the presumption that it must have known and assented to defendant's requirements, but such knowledge and consent were not in our opinion established.

"If there is doubt and uncertainty about the effect of the correspondence upon the contract, they should, on familiar principles be resolved in favor of sustaining the contract as made and signed, and not of defeating it; in favor of the insured rather than the insurer."

Where a surety company issues a bond indemnifying a bank against default of its cashier, and the application made by the bank warranted that the books of the cashier would be examined by the auditing committee once in each month, but not on any fixed monthly date, the examination by the auditing committee composed of certain directors of the bank was sufficient though they were not expert accountants.[1]

The Supreme Court of California held in Young *v.* Pacific Surety Company[2] that such a statement in an application for fidelity insurance that the insured would himself examine and audit the books and all moneys, securities, vouchers, etc., in the hands of the risk, constituted a warranty, and that the failure to make such audit during the insured's absence from the city for four days, during which a loss occurred, relieved the insurer from liability thereunder.

In T. M. Sinclair Company, Limited *v.* National Surety Company[3] the court held that where the risk named in a fidelity insurance policy was required by his contract with the insured to make certain reports on sales, which, if made, would have shown condition of the "risk's" accounts, the provision of the fidelity insurance policy requiring the insured to make frequent audits and examinations of the "risk's" accounts was breached by failure on the part of the insured to examine with reasonable frequency the accounts furnished by the "risk."

Again, attention is called to the case of Phenix Insurance Company *v.* Guarantee Company of North America.[4] Here an application to a surety company for a bond to secure the

[1] Am. Bond. Co. *v.* Morrow, 80 Ark. 49; 96 S. W. 613.

[2] 137 Cal. 590; 70 Pac. 660.

[3] 132 Ia. 549; 107 N. W. 184.

[4] 115 Fed. 964.

faithful performance of his duties by the cashier of the applicant, a corporation, contained the following questions and answer:

"'Will he receive remittances from customers on accounts? If so, how often will you render customers a statement of balance due by them, and by whom will this be done? This should be done by some other person than the applicant, and is made as a means of verifying the balances appearing on the ledger.'

"*Answer.* 'Yes. Monthly by the bookkeeper.'"

Held, that such answer was not a warranty that such monthly statements should be delivered to the customers or deposited in the mail by the bookkeeper personally, but that it was complied with where such statements were made out by the bookkeeper and deposited by him in sealed envelopes in the receptacle used for taking mail and according to the customary practice of the corporation's business.

Such application also contained the following questions and answers:

"'It is suggested (1) that all moneys and checks received be deposited intact in bank and all disbursements be made either by check or from a petty cash fund drawn from the bank as required; and (2) that all checks received be indorsed for deposit to prevent any loss or conversion. To what extent are these provisions to be followed?'

"*Answer.* 'Fully.'"

It was held that the employer complied with such warranty by adopting the regulation requiring all checks to be deposited, indorsed as therein specified, and by exercising a reasonable supervision over its cashier to see that the practice was pursued; that the answer to such questions could not be construed as an absolute warranty by the employer that its cashier would deposit all checks, properly indorsed, and to relieve the surety from liability for the failure to make such deposits contrary to the employer's regulations, and without its knowledge, where it exercises reasonable diligence in the premises, which would render the contract nugatory, as one for indemnity. In making this holding

the court observed that "if the indemnity company cannot be held liable in this case, it never can be held liable in any case. In short, if we give the alleged warranties the scope which the defendant claims should be given to them, no bond of indemnity would ever be taken out by an employer because he would assume the full burden of watching his employee and relieve the indemnity company of all responsibility."

The general rule is that if a condition known to the obligee upon which a surety agrees to be bonded is not complied with, that the surety is discharged.[1]

In the case of United States Fidelity and Guaranty Company *v.* Downey [2] a guaranty company gave a bond to a "union" to secure the faithful discharge of the duties of its treasurer. The "union" in its application stated that the treasurer's accounts would be examined and verified every three months by its trustees. The application stipulated that the statements were warranted to be true, and that the business of the "union" should be maintained as stated. In February it was learned that the treasurer was short in his accounts. A quarterly examination of the books had been made in December preceding at which time it was found that he should have had on hand $740. He then showed a bank book with deposits of $40 and the balance on deposit in cash. The account in the bank was not verified. It was held that the "union," having failed to verify the funds in the possession of the treasurer, as required by the application, relieved the insurer of liability under its policy.[3]

§ 85. (H) **Warranty that All Due and Customary Supervision over the "Risk" shall be observed by the Insured.** — Fidelity policies usually provide that the insured shall observe or cause to be observed all due and customary supervision over the "risk" for the prevention of default on his part. Such a provision of the policy as is here referred to was discussed at some

[1] Fid. & Dep. Co. *v.* Courtney, 186 U. S. 342; 46 L. E. 1193.

[2] 38 Col. 414; 88 Pac. 451.

[3] See also Elgin Loan & Sav. Co., *et al.* *v.* London Guar. Acc. Co., 11 Ont. L. Rep. 330.

length in the case of Guarantee Company of North America *v.* Mechanics Savings Bank and Trust Company.[1] There the court spoke as follows:

"The company's defence did not rest on the duty of diligence growing out of the relation of the parties, but on the breach of one of the stipulations entered into between them; (to wit, that all due and customary supervision of the 'risk' by the insured would be observed.) The question was not merely whether the conduct of the bank was contrary to the nature of the contract, but whether it was not contrary to its terms. Engagement in speculation or gambling was what the company sought to guard against, because experience had admonished it of the probability that speculation or gambling would lead to acts involving loss for which it would be responsible. Bad faith, in view of the courts below, would not exist if the bank had such confidence in Schardt's integrity that it accepted his bare statement that he was not speculating as overcoming the weight of his admission that he had been. How anything but such a denial could be expected, it is not easy to see, nor how careful and prudent men could have been justified in omitting independent inquiry.

"The truth is that, in spite of strict supervision and the pursuit of the best systems of keeping accounts, there is always a risk of defalcation. The prevention of defaults or their detection at the earliest possible moment are of even more vital importance to financial institutions than to the guarantors of the fidelity of their employee. The provisions intended to protect the company in this case were not in themselves unreasonable, and, so far as they operated to compel the bank to exercise due supervision and examination and due vigilance, were consistent with sound public policy. We think it was the duty of this bank to have made prompt investigation, or, at all events, to have notified the company at once of the information that it had; and we decline to hold that the bank's misplaced confidence in Schardt affords sufficient ground for enforcing the liability of the surety company on the theory of good faith. Our conclusion is that the failure of the bank in the particulars adverted to, defeats a recovery on the teller's bond for defalcation after information of Schardt being engaged in speculation was received."

Attention is called in this connection to the construction given by the same court in a recent case[2] to a similar clause

[1] 183 U. S. 402; 80 Fed. 766; 100 Fed. 559.

[2] Fid. & Dep. Co. of Md. *v.* Courtney, 186 U. S. 342; 46 L. E. 1193.

contained in a fidelity insurance policy which read as follows: That the employer shall observe, or cause to be observed, due and customary supervision over the risk for the prevention of default. In commenting upon the foregoing the court spoke as follows:

"It is well settled that in the absence of express agreement, the surety on a bond given to a corporation, conditioned for the faithful performance by an employee of his duties, is not relieved from liability for a loss within the condition of the bond by reason of laches or neglect of the Board of Directors not amounting to fraud or bad faith, and that the acts of ordinary agents or employees of the indemnified corporation conniving at or coöperating with a wrongful act of the bonded employee will not be imputed to the corporation.

"Corporations can act only by officers and agents. They do not guarantee to the sureties of one officer the fidelity of the others. The rules and regulations which they may establish in regard to periodical returns and payments are for their own security, and not for the benefit of the sureties. The sureties, by executing the bond, become responsible for the fidelity of their principal. It is no collateral engagement into which they enter, dependent on some contingency or condition different from the engagement of their principal. They become joint obligors with him in the same bond, and with the same condition underwritten. The fact that there were other unfaithful officers and agents of the corporation, who knew and connived at his infidelity, ought not in reason and does not in law or equity relieve them from their responsibility for him. They undertake that he shall be honest though all around him were rogues. Were the rule different, by conspiracy between officers of a bank or other moneyed institution, all their sureties might be discharged. It is impossible that a doctrine leading to such consequences can be sound."

Attention is called in this immediate connection to the ruling of the Supreme Court of North Carolina as presented in Bank of Tarboro *v.* Fidelity and Deposit Company of Maryland.[1] In this case it was held that the kind of supervision required of the insured under policies of fidelity insurance is such as ordinarily prudent business men would give under similar circumstances.[2]

[1] 128 N. C. 366; 38 S. E. 908.

[2] See also T. M. Sinclair & Co., Ltd. *v.* Nat. Sur. Co., 132 Ia. 549; 107 N. W. 184.

Again, in the case of United States Fidelity and Guarantee Company *v.* First National Bank of Dundee,[1] the court spoke as follows:

> "If bank officers are to be held to such a rigid method of examination and supervision over the accounts of their employees, there would be but little necessity, if any, for fidelity insurance. When a trusted employee conceives a scheme of criminal misappropriation of his employer's money, he at the same time matures his plans for covering up his wrong-doings. He has many advantages over his employer since he knows what the real facts are, and is therefore always on his guard to allay suspicion, while the employer is ignorant of the real facts and therefore not speaking. In this case the evidence shows that the defaulting insured had an excellent reputation for honesty and fidelity, and not the least suspicion existed that he was not entirely honest and worthy of the confidence reposed in him."

We now come to a consideration of those cases, where the fidelity bond sued on contains no warranty to the effect that the insured will exercise any supervision over the "risk," but where the insured insists that such duty arises out of the relation of the parties.

This brings up for consideration the question whether what was known in the old-time law of private suretyship as the "doctrine of laches" has any application to contracts of fidelity insurance. From what has been said by the courts in certain English cases, it might be supposed that the doctrine of laches was in all respects applicable to such contracts.[2]

In the case of Board of Education *v.* Citizens' Insurance Company [3] the proposal for a guaranty policy contained a statement which was made a warranty to the effect that the books of the "risk" should be balanced at the end of each year, and the cash and securities appearing to the credit of the insured at each balancing time would be examined by its auditor, and the evidence showed that this was not done. Another warranty was to the effect that money should be drawn from the

[1] 233 Ill. 478; 84 N. E. 670.

[2] See Bryne *v.* Muzio, L. Rep. Ir., 8 C. L. 396; Guardians of Westport Union *v.* O'Malley, L. Rep. Ir., 8 C. P. 412.

[3] 3 Upper Can. C. P. 132.

bank by the "risk" only by the authority of the insured. The course actually pursued was for the chairman of the insured as its secretary to sign orders to the "risk," directing him to pay bearer so much money. The "risk" then drew his check for the amount without this being signed by any officer of the insured and without attaching the order. Consequently there was nothing that prevented the "risk" from overdrawing moneys for his own use, which he did. It was held by the court that the terms of the policy had not been complied with, and that the cashier had been guilty of such laches as would release the insured from liability under the policy. However, in a later case [1] it was held that the insured's right to recover was not affected because the insured placed extraordinary confidence in the "risk," such confidence involving no violation of the express terms of the policy.

The courts in this country have almost uniformly refused to adopt the English doctrine of laches as the same has been applied in the courts of that country to contracts of fidelity insurance.

In the case of Ætna Insurance Company *v.* American Surety Company,[2] P., the general agent of a life insurance company, having on his own motion applied to defendant, a "surety company," to furnish to his employer a guaranty policy, that company forwarded to the secretary of the insurance company a certificate which, when filled out and signed by him, recited that the agent, "so far as the secretary's knowledge went," had always faithfully performed his duties, and that he was not then "in arrears or default." It also stated that his accounts "were last examined June 13, 1884, and found to be correct in every respect." This certificate bore date June 16, and the bond June 15, 1884. As a matter of fact P. was then in the company's debt $150, on a draft which he had drawn on the company in March, 1884, and which it had paid, but had required an explanation thereof and demanded repayment.

[1] London Guar. Co. *v.* Hochelaga Bank, 3 Quebec, Q. B. 25.
[2] 34 Fed. 291.

He had had correspondence with the secretary about renewal receipts, the natural inference from which was that the money which they called for had been paid. The company did a very large business, its cash premium income for 1884 being about $2,400,000; and P.'s agency was a comparatively small one. It was also its practice to leave accurate investigation of such agencies until the annual examination, which was had in December. It was held that the unpaid draft was not "arrears or default" within the meaning of the certificate, which referred to collection accounts, and that the secretary was not guilty of such laches as would discharge the "surety company" from liability on the policy for a subsequent defalcation. P. thereafter continued the same system; sending his June report August 4, his July report August 24, and his August report September 29. He was written to October 1, his attention being called to the matter and an explanation demanded. He thereupon returned, about October 8, a list of outstanding renewal receipts, and in his September report, which was sent October 29, accounted for all the older collections. His October report came in November 14, and contained nothing but September collections. The insurance company did a very large business, and P.'s agency was a small one, the accurate investigation of which it was the custom to leave until the annual examination, which took place in December. It was held that the company was not guilty of laches in not communicating P.'s delays to the "surety company."

The court said in passing on the question that "the remaining branch of this case is, Did English, secretary of the insured, have adequate reason to know of P.'s defalcation or unfaithfulness? For, although he did not know the facts as to the agent's conduct, yet if his ignorance arose from gross negligence in not ascertaining facts which were within his means of knowledge, he is chargeable with misrepresentation. I cannot find that English ought to have known these facts, or that he was guilty of laches in not knowing them. A requirement which should compel an employer, who is merely

stating his opinion, to use, for the benefit of a proposed surety, great vigilance in regard to the accounts of an employee, and greater vigilance than the successful employer uses himself in his own large business and which has heretofore apparently proved to be adequate, is one which neither law nor good reason demands.

"It is the business of the surety to see that his principal keeps within the guaranty of the bond and not that of the employer. The employer is not called upon to be diligent and watchful in order that the surety may not suffer loss." [1]

In National Bank of Asheville *v.* Fidelity and Casualty Company of New York,[2] the court observed that it was true in the case of fidelity insurance policies that the insurer is not discharged because the insured might by the existence of diligence have learned of the existence of dishonesty on the part of the "risk," and thus by the exercise of more care have sooner discovered the loss.

In Fidelity and Casualty Company of New York *v.* Gate City National Bank,[3] it was held that although the contract may have required the bank, upon the discovery of any fraud or dishonesty on the part of such employees, to give notice thereof to the company, and also immediately after knowledge by the bank of the occurrence of any act on his part involving a loss to the company of more than $100 to notify the company of the same, yet where such contract contained no stipulation making it in the least degree incumbent upon the bank to exercise any diligence or care in inquiring into or supervising the conduct of this particular employee, or of any of his co-employees in its service, and imposed upon it no duty of vouching for the fidelity or efficiency of the latter, or of requiring them to watch and report upon his actions and doings, information or knowledge on the part of the bank's cashier — he being only such a co-employee — as to the mat-

[1] See also Pacific Fire Ins. Co. *v.* Pacific Sur. Co., 28 Pac. 842; 93 Cal. 7.

[2] 89 Fed. 819; 32 C. C. A. 355.

[3] 33 L. R. A. 821; 97 Ga. 634; 25 S. E. 392.

ters concerning which the company had stipulated for notice would not, relative to it, be, under these circumstances, imputable to the bank itself.

Finally attention is called to the case of Fidelity and Casualty Company of New York *v.* St. Matthews Savings Bank.[1] This was an action wherein a policy had been issued by a guaranty insurance company upon one Zimmerman as cashier for the insured bank. Zimmerman, the "risk," defaulted and suit was brought on the policy by the insured to recover the sum of $10,000 from the insurer. The latter interposed, among other defences, breach of warranty and misrepresentation on the part of the president of the insured bank, as well as negligence and want of due care on the part of the insured in not sooner discovering the defalcations of the "risk" which covered a considerable period of time. The case was referred to a master for findings of fact and conclusions of law, and the latter found for the insured and assessed damages against the insurer in the sum of $7047.85. These findings were approved by the trial court, and an appeal was taken thereafter to the United States court of appeals for the fourth circuit. This court affirmed the findings of the referee and the order for judgment of the lower court in favor of the insured. In reviewing and approving these findings the court spoke as follows:

> "The defendant's (the insurance company) exceptions were, in substance, that the master erred in finding as a conclusion of law that the proof was not sufficient to show negligence and want of due care on the part of the plaintiff and its officers in the supervision of the bank and cashier as would relieve the defendant from liability on its guaranty bond; that the master erred in holding that he was not prepared to extend to a surety in a cause like this the same leniency which the law extends to a surety on a personal bond, because the latter assumes the risk through feelings of kindness, and the former as a matter of business, for a pecuniary consideration and for the purpose of profit."

The court further said in this connection:

[1] 104 Fed. 858; 44 C. C. A. 225.

"The order referring the case to a special master directed him to hear and decide all matters of law and fact involved in the case. His findings are clearly within the scope of the order. The court below gave them the weight to which they are entitled under the principles well settled by the decisions to which we have referred. The circuit court was correct in holding that the findings of the master could not be disturbed except for gross error or fraud or misconduct on his part. No evidence of such error or misconduct appearing in the record, the judgment of the circuit court is affirmed." [1]

§ 86. (I) **Warranty as to the "Risk" having other Business than that of his Employment with the Insured.** — This warranty, like some of the others that have preceded it, is evidently called for more with a view of enabling the insurer to determine whether the proposal for a policy shall be accepted or not than as affording a basis for avoiding liability in case of any subsequent breach thereof. From a practical standpoint the warranty is inserted in order to make sure that the "risk's" attention shall be given solely to the employment contemplated by the policy, and that he shall not become involved in outside business transactions which might cause him to get into financial difficulties, impair his financial status or even lead him to commit an act of fraud or dishonesty in one employment to make good losses incurred in another.

Where a bank on applying to a surety company for a bond indemnifying it against default of its cashier warranted that he was not engaged or about to be engaged in any other business, but was at the time secretary of a local board of directors of a building association, it was held that this did not amount to a breach of warranty.[2]

If in fact the officer of a corporation whose fidelity is insured sustains other relations to the company than those indicated in its statement on which the bond was executed, and which were essentially different, and involved the receiving

[1] See generally, on the question of laches, De Jennette *v.* F. & C. Co. of N. Y., 98 Ky. 558; 33 S. W. 828; Jackson *v.* F. & C. Co. of N. Y., 75 Fed. 359; 21 C. C. A. 394.

[2] Am. Bond. Co. *v.* Morrow, 80 Ark. 49; 96 S. W. 613.

and expenditure of the employer's money, a failure to disclose such relations is a defence to liability of the surety company on its bond.[1] In a recent case error was assigned to the instruction of the court to the jury as follows:

"The court further instructs you that the defendant in this action, by its written application in evidence, undertook to guarantee the fidelity of Mr. Bell as secretary and assistant treasurer, but did not undertake to guarantee his fidelity in any other capacity, and if Mr. Bell sustained any relation to the plaintiff, to disclose such relation, and if you find from the evidence in this action that at the time the bond in question was written Mr. Bell was the sales agent of the plaintiff as well as the secretary and assistant treasurer, then I instruct you that it was the duty of the plaintiff to disclose that fact to this defendant, and if you find that Mr. Bell's positions were to the effect of his having been a sales agent or to his duties or responsibilities in such a way as to increase the obligation of this defendant upon its bond, then I instruct you, that, as a matter of law, the defendant is released, and your verdict should be in its favor." [2]

"This instruction was based upon the contention of the plaintiff in error that the original statement made by one Power on behalf of the insured concerning the office and duties of Bell was false in that it failed to show that Bell in addition to holding the offices of secretary and assistant treasurer was also a salesman for the company, and in that capacity received and expended considerable sums of money. The employer's statement to the defendant in error contained no reference to his duties as salesman. It was shown in the evidence that he was such salesman and that he sold coal to the railroads, steamboats and steamships and to manufacturing plants and sold coal locally; that sales were made largely on his personal efforts and with the assistance of others whom he engaged for that purpose, and that his average monthly expenses for selling coal were about $300 a month which he spent upon the streets and in the neighborhood of Seattle in his efforts to procure sales of coal. Plaintiff in error contends

[1] Issaquah Coal Co. *v.* U. S. Fid. & Guar. Co., 126 Fed. 89.

[2] Issaquah Coal Co. *v.* U. S. Fid. & Guar. Co., 126 Fed. 89.

that the charge was not justified by the pleadings, but the record shows that the evidence was introduced without objection, and that the point that it was not warranted by the pleadings is made for the first time in this court. We think the objection comes too late. Nor do we find an error in the instruction. If in fact the officer whose fidelity was insured sustained other relations to the company than those indicated in the employer's statement — relations essentially different from those that were indicated, and which involved the receipt and expenditure of the company's money, the insurer was entitled to be informed thereof." [1]

CHAPTER XI

(VI) DISCHARGE OF LIABILITY BY BREACH OF CONDITIONS

§ 87. **Conditions defined and discussed.** — A condition in a fidelity bond or insurance policy is a formal alternative statement of a provision inserted in the body of the policy which operates to suspend, limit or avoid the principal obligation of the insurer to the insured, in case the latter fails to comply with the terms. Conditions differ from representations in that they form part of the contract of insurance and are inserted as such therein. They frequently differ on the other hand from warranties in that they are inserted directly in the policy, and do not arise by reference to previous statements contained in the application or proposal which are made part of the contract only by reference thereto in the policy subsequently issued in compliance with such application or proposal.[2]

As the effect of a breach of the conditions of a policy, on the liability of the insurer is, generally speaking, to suspend, limit

[1] Issaquah Coal Co. *v.* U. S. Fid. & Guar. Co., 126 Fed. 89.

[2] Rice *v.* Fid. & Dep. Co., 103 Fed. 427; 43 C. C. A. 270.

or avoid liability thereunder, the courts have adopted the rule of construing all such "defeasance clauses" strictly in favor of the insured and against the insurer.[1]

With the acceptance of the policy by the insured, all conditions therein become covenants which serve to define and regulate the duties of the insured to the insurer. With this state of facts in mind, it may be said that as between the parties to the contract, a faithful observance of all covenants of the policy is essential on the insured's part if he desire to enforce fulfilment of the reciprocal covenants on the part of the insurer. For he who commits the first substantial breach of a contract cannot maintain an action against the other contracting party for a subsequent failure to perform.[2] With respect to the necessity of at least a substantial performance of all the conditions of the policy of fidelity insurance, in order to keep the same alive, the remarks of the court in Robertson *v.* United States Credit System Company[3] are directly in point:

> "'It is undoubtedly a general rule,' observed the New Jersey court in that case, 'that if a party enter into an absolute contract, without any qualification or exception, and received from the party with whom he contracts the consideration of such engagement, he must abide by the contract and either do the act or stand the consequences. No matter how harsh or unjust in its operation this rule may appear, it cannot be denied that it has its foundation in good sense and flexible honesty.'"

There, however, seems to be a tendency on the part of the courts by the adoption of the "substantial compliance rule," to give all conditions a liberal construction. This for the purpose of giving effect to the supposed intention of the parties, so as to carry out rather than defeat the purposes for which they were intended. From this standpoint it appears just that conditions in policies of guaranty insurance should neither on the one hand be so narrowly or technically interpreted as to frustrate their obvious design, nor on the other

[1] Am. Bond. Co. *v.* Morrow, 80 Ark. 49; 96 S. W. 613.

[2] Strouse *v.* Am. Ins. Cr. Co., 91 Md. 244; 46 Atl. Rep. 328.

[3] 57 N. J. L. 12; 29 Atl. Rep. 421.

hand be construed so loosely or artificially as to relieve the insurer from liability fairly within the scope or spirit of the policy.[1]

It should be noted that under the peculiar wording of conditions as found in the usual form of fidelity insurance policies, they in effect cover the entire domain of fidelity insurance law as heretofore discussed herein under the heads of misrepresentation, concealment and warranty. The legal effect, however, of a breach of any of the conditions named in the policy differs materially from that which exists in the case of mere misrepresentation or concealment. There is, however, very little difference in legal effect, between breach of conditions and breach of warranty.

§ 88. **The "Doctrine of Waiver" in its Application to Breach of Conditions, as between the Insurer and the Insured.**— In no other branch of fidelity insurance law has the "doctrine of waiver" a wider or more important bearing than with reference to the subject of conditions and alleged breaches thereof. For no matter how great may have been the violation of the conditions on the part of the insured the right to avoid the policy by reason thereof may be waived by the insurer either directly or indirectly. A waiver, as the term is here used, is either the result of an intentional relinquishment of a known right or an estoppel from enforcing it. To constitute a waiver there must be an intention to relinquish the right, or there must be words or acts calculated to induce the other contracting party to believe, and which deceives him into the belief that the holder of the right has abandoned it ; and the party must have acted on this belief, so that an assertion of the right will inflict upon him a loss he would not have sustained if its holder had not appeared to relinquish it.[2]

[1] See Model Mill Co. *v.* Fid. & Dep. Co., 1 Tenn. Ch. Ap. Rep. 365.

[2] Rice *v.* Fid. & Dep. Co., 103 Fed. 427; see also Bank of Asheville *v.* F. & C. Co. of N. Y., 89 Fed. 819; M. S. & L. Ass. *v.* M. K. & T. Tr. Co., 73 Mo. App. 161; Am. Cr. Ins. Co. *v.* Champion Coated Paper Co., 103 Fed. 609; 43 C. C. A. 340; Am. Cr. Ins. Co. *v.* Wood, 73 Fed. 81; 19 C. C. A. 264.

The question whether or not a breach of the condition of a policy has been waived or not is ordinarily a question for the jury.[1] There is no necessity that the waiver should be in writing.[2]

The federal court of appeals for the eighth circuit said on the general subject of waiver that "it is now well settled by the weight of authority that an insurance company may waive a forfeiture or a defence to an action on an insurance policy by acts *in pais* from which an intention to waive may be inferred and that such a waiver need not be based on a new consideration or amount to a technical estoppel. If after a loss has happened and the fact becomes known to the insurer that a defence thereto exists or that a forfeiture has been incurred, it takes affirmative action amounting to a confession of its liabilities which induces the insured to believe that the loss will be paid and to do acts based on such belief which are attended with some trouble or expense, such conduct will amount to a waiver. The rule is that when an insurance company becomes aware that all rights under a policy have been lost, it cannot for an indefinite period disguise its purpose to resist payment of the loss by affirmative action which would rationally lead the insurer to believe that it admits its liability and intends to discharge it." [3]

In a Missouri case the insured sought to avoid the effect of a stipulation providing for immediate notice of any loss that might give rise to liability, by the claim made that the insured afterwards waived this provision of the contract. It seems that in March, 1893, the insured's attorney wrote to the insurer, notifying it of the "risk's" defalcation. In answer thereto the insurer wrote that among other reasons why it thought

[1] Rice *v.* Fid. & Dep. Co., 103 Fed. 427; 43 C. C. A. M. K. & Tr. Co. *v.* German Nat. Bank, 77 Fed. 117; 23 C. C. A. 65.

[2] Hellman *v.* C. T. S. O. & Sur. Co., 111 N. Y. App. Div. 879; 98 N. Y. Sup. 511.

[3] M. K. & T. Tr. Co. *v.* German Nat. Bank, 77 Fed. 117; C. C. A. 65; see also Nor. Ev. Luth. Beth. Cong. *v.* U. S. Fid. & Guar. Co., 81 Minn. 32; 83 N. W. 487.

the company was not liable, was that the "risk" at the time and in the act of embezzling the insured's funds, was acting beyond and without the scope of the duties contemplated in the policy. In passing upon the question of the "waiver" the court spoke as follows:

"We do not think that their letter can be treated as a waiver or abandonment of all defences save and except the one that the 'risk' was at the time acting beyond the scope of employment for which the policy was given. Waiver has been defined as an intentional relinquishment of a known right. Or, as said by a learned judge, to make out a case of abandonment or waiver of a legal right, there must be a clear, unequivocal and decisive act of the party showing such a purpose or acts amounting to estoppel on his part. In Stiepel *v.* Life Association[1] Judge Rumbauer says 'that a "waiver" depends solely upon the intention of the party against whom it is invoked, and it is in that respect different from estoppel. It is not meant by this, however, that every secret understanding is to control, for a party's intent will be construed from this act or what he may do or write. The point here is that there was nothing in the defendant's letter of March, 1893, which could reasonably lead the insured to believe or infer that defendant rested his defence solely on the alleged ground that the agent had embezzled insured's money while employed outside the work contemplated in the policy. The letter does not specify this, but rather insists that the insurer has other reasons for delaying liability; the letter mentions this "among other reasons" which are specified.'"[2]

§ 89. **Conditions classified.**— For the purpose of treatment herein, conditions in policies of fidelity insurance may be divided into seven classes as follows:

First. Conditions in the nature of warranties.

Second. Conditions precedent to the creation of liability under the policy.

Third. Conditions precedent to the maintaining of continuous liability under the policy.

Fourth. Conditions by way of absolute limitation on the liability of the insurer to the insured under the policy.

[1] 55 Mo. App. 224.

[2] See also Sun Life Ins. Co. *v.* U. S. Fid. & Guar. Co., 130 N. C. 129; 40 S. E. 975; Ridgley *v.* U. S. Fid. & Guar. Co., 73 N. W. 874; 103 N. W. 669.

Fifth. Conditions excepting certain perils for which the insurer shall not be liable under the policy.

Sixth. Conditions subsequent necessary to the fixing of liability upon the insurer after the occurrence of a loss involving a contingent liability under the policy.

Seventh. Conditions determining the extent of liability, after the same has become fixed save as to amount.

§ 90. (I.) **Conditions in the Nature of Warranties.**—A custom quite general in its scope has grown up among the guaranty insurance companies of incorporating in the form of express conditions in the body of a policy a number of matters referred to in the proposal and application which are themselves made warranties. In no instance do they differ materially from those affirmative and promissory warranties that have already been considered at length, and the only purpose of inserting them specifically in the policy arises from an effort on the part of the insurer to give to their breach a wider effect in law than they might perhaps otherwise have, if they existed only as warranties.

The following are the four principal conditions in the nature of warranties:

(A) A condition providing that the business of the insured shall continue to be conducted and the duties, powers and remuneration of the "risk" shall remain in accordance with the statements contained in the proposal; and that if, during the continuance of the policy, any circumstances shall occur, or change be made, which shall have the effect of making the actual facts differ from such statements or any of them, without notice thereof being given to the insurer, and its consent and approval in writing being received, the policy as to such "risk" shall be void from the beginning.

(B) A condition providing that if any material change shall occur or be made during the term of the policy with respect to the method of checking the "risk's" accounts, or with reference to supervision of the same by the insured as set forth in the proposal for the policy as theretofore made, then

the policy shall thereupon cease and become null and void as to such "risk."

(C) A condition that the policy shall become void from the beginning if the "risk" has within the knowledge of the insurer been a defaulter at any time during any prior service with the insured or with third parties.

(D) A condition to the effect that any wilful suppression of a material fact by the insured in any statement or declaration to the insurer shall render the policy void from the beginning.

§ 91. (A) **Conditions providing that the Business of the Insured shall continue to be conducted and the Duties, Powers and Remuneration of the "Risk," shall remain in accordance with the Statements contained in the Proposal; and that if during the Continuance of the Policy any Circumstances shall occur or Change be made which shall have the Effect of making the Actual Facts differ from such Statements or any of them, without Notice being given thereof to the Insurer, and its Consent and Approval in Writing being obtained, the Policy as to such "Risk" shall be Void from the Beginning.** — In its nature the foregoing condition is closely akin to a warranty and under the provisions thereof any failure to observe its terms may be said to render the policy void from the beginning. To properly construe and apply such a condition as the foregoing, it must be borne in mind that the contract of insurance had between the insurer and the insured is always entered into with direct reference to the terms of a collateral contemporaneous contract existing between the insured and the "risk."

The condition stated above may perhaps be considered as a formal recognition by the insurer which drafted the policy of the principle that in order to release the insurer from liability by reason of material alterations in the contract had between the insured and the "risk," such last-named collateral contract must be written into the policy in order that material alterations therein shall have the effect of releasing

the insurer from liability under its contract with the insured. The condition refers to and is based upon written representations made by the insured to the insurer prior to the issuance of the policy which are themselves made a subject of a warranty by the insured. They constitute promissory warranties, and the fact that the insurer in drawing the contract has not seen fit to trust to the courts to treat them purely as promissory warranties and not as conditions, might possibly lead to the supposition that the insurers themselves regard breaches of promissory warranties and breaches of conditions as calculated to give rise to different legal results. Therefore, the insurers have sought, as it were, to define the legal effect of such breach of warranty by transforming such warranty into a condition of the policy itself, providing that any breach thereof shall render the policy void from the beginning. Such conditions as these now under consideration seem — so far as the effect of a breach thereof is concerned — to be entirely in accord with the principle laid down in the United States to the Use of the Anniston Pipe and Foundry Company *v.* American Surety Company [1] to the effect that contracts of guaranty insurance being given to secure the faithful performance of a contract, that any material change made in the contract as between the insured and the "risk" will have the effect in law of discharging the insurer from liability under the policy.[2] In the case of Livingston, *et al.* *v.* Fidelity and Deposit Company [3] the facts briefly stated were as follows: A fidelity bond was issued containing the following clause: "This bond is entered into on the condition that the business of the employer shall continue to be conducted and the duties and remuneration of the 'risks' shall remain in accordance with the statements hereinbefore referred to."

As qualifying the above it was also provided in the bond that

[1] 92 Fed. Rep. 549; 34 C. C. A. 536.

[2] See also House *v.* Am. Sur. Co., 21 Tex. Civ. App. 590; 54 S. W. 303; U. S. *v.* Am. Bond. & Tr. Co., 89 Fed. 921; Globe Sav. & Loan Co. *v.* Emp. Lia. Assur. Corp., 13 Manitoba, 531.

[3] 76 Ohio 253; 81 N. E. 330.

the insured should have the right on giving written notice, to make interchanges as to the several "risks" upon terms mentioned in the bond. The bond further provided that the insurer should not be liable for other than the personal acts of the "risk" within the direct scope of his duties named in said schedule or in said notice. Desiring to substitute another person as secretary, the insured made written application January 25, 1897, and in that paper defined the duties of that officer thus:

> "Receive and deposit moneys received by the company and act as secretary in general, having the custody of cash, likely not more than $1500, and of that only about twenty-four hours. Not authorized to pay out cash on account, but required to make deposit in the authororized depository, the National Park Bank. Allowed in conjunction with the president and treasurer to indorse checks, but for deposit only, and not authorized to sign checks nor accept drafts."

The representations respecting the powers and duties of the secretary were not subsequently changed. This application contained the agreement that the answers were to be taken as conditions precedent and as the basis of the bond. At the expiration of the year, viz: June 1, 1897, application in writing was made by the insured for a renewal, and the company certified that each of the employees named in the accompanying list had faithfully and satisfactorily performed his duties and promptly and correctly rendered his accounts during the preceding year. In this application Blodt, the defaulting employee, is classed as general manager, and the obligation as to him is $5000. Again, at the expiration of the year application was made for a renewal and in that application Blodt was named as Secretary with the same amount as guarantee. The same certificate as to faithful performance of his duties as in the one preceding accompanied his application. Like application with like certificate as to performance of his duties was made in each of the three years following, Blodt being continued as Secretary. He resigned August 8, 1901, and then the crash came. Com-

menting on the foregoing facts, in an action to enforce the insurer's liability on its policy, the court spoke as follows:

"But were the defaults of Blodt, whether to be regarded as embezzlements or larcenies or by whatever name denominated, within the line of his duties as secretary. These duties, so far as the money of the company is concerned, are specifically defined. The secretary is authorized to receive money and it is his duty to deposit it. This specification as to deposit of funds by the secretary is in conflict with §§ 4 and 5 of the by-laws, which provide, that the 'secretary shall receive all moneys paid to the company, and enter the same in the proper books,' and that the 'treasurer shall receive and have custody of all the moneys of the company, and promptly deposit the same in such bank or banks as the board of directors may designate,' thus implying that the secretary should pay the moneys received to the treasurer. But whichever shall be taken as the controlling provision regarding deposits of money, it is entirely clear that nowhere is authority given to the secretary to withdraw the funds, and that so far as the money was concerned, his duty had been exhausted when he properly deposited it. It is provided by § 3836, Act 4, Rev. Stat., that the treasurer shall deposit all funds in the bank designated by the board of directors and that they can be withdrawn only by check signed by the president and financial secretary or such other officer as the board of directors may designate. In making deposits of funds received by him, Blodt was acting as secretary, but the fact that the signature of the secretary to checks is contemplated by the above cited statute does not suggest that he has authority to use the checks ; the contrary inference is apparent. Nor had he any duty as secretary to pass upon applications for loans nor perform the duties of an appraisal committee in the examination of the securities offered, nor the duty of the board of directors in authorizing expenditures. All these acts, while necessary in the working out of Blodt's fraudulent scheme, were not only not within the direct scope of his duties, but were wholly without any of the specified duties. The frauds upon the company, to which these transactions were incidents, were not therefore the frauds of Blodt as secretary, but were acts which, by the gross negligence of the company, he was permitted to do foreign to the duties imposed upon him by the schedule, as well as the statute, and the by-laws of the company.

"Let us recur again to the provision of the bond. The fidelity company is to make good to the loan company any loss sustained by reason of the fraud or dishonesty of the employee 'in connection with

his duties as specified in said schedule,' and the 'company shall not be liable for other than the personal acts of the employees within the direct scope of their duties named in said schedule." These are controlling provisions. If we are right in these deductions from them and from the facts of the record, and they seem inevitable, then it follows that Blodt's frauds did not come within the direct scope of his duties as secretary, and that therefore they are without the obligations of the bond and the fidelity company cannot be held for them."

To a large extent the scope of the insurer's liability is dependent upon and controlled by the statements in the proposal and application for a policy with respect to the nature of the powers and duties of the "risk," wherein it is agreed that they shall remain and continue during the entire list of the policy as set forth in such application. It needs but little elaboration to show the importance of the condition here referred to. The chances of liability for the insurer under the proposed policy depend largely upon the nature of the "risk's" duties and the authority which he will have while performing such duties. It may be said that the question as to the scope of the "risk's" authority is ordinarily a question of law. In a Pennsylvania case the insurer claimed that it was for the court, in the first instance, to determine as a matter of law whether or not the insured's loss was covered by the policy issued by the insurer. On this point the court said:

"The counsel for the insured urges most strongly that the duties imposed upon the 'risk' were conferred by the by-laws of the insured association, and that he had only such duties in a way of supervision and general management of the business of the corporation as were incident to that position, and that he had nothing to do with the financial operations of the corporation, and that all matters relating thereto were covered by the duties of the treasurer. It is claimed that the contract between the parties shows such to be his duties, and that it should have been so construed by the court, and the question as to his duties should not have been submitted to the jury. We cannot agree with the learned counsel. It is true, as he suggests, that the liability of a surety is not to be extended by implication beyond the terms of his contract, and

that any material alteration therefrom may discharge the surety. Ferris, the 'risk' was appointed general manager of the association, and as such gave bond to secure his employer against any fraud or dishonesty in the performance of the duties of his position. But what were those duties? They were not specifically defined in the contract itself so that the court could as a matter of law ascertain and determine them. This, then, became the duty of the jury under the evidence in the case."[1]

In this same case it was held that parol evidence as to the duties of the "risk" and as to the amount of money received and embezzled by him is admissible. This on the theory that it amounted simply to showing that the duties of the "risk" were the receipt and temporary custody of the funds of the insured. The court remarked that such "testimony in no way changed or enlarged the liability of the insurer to the insured; nor did it show any duties or responsibilities different from those set forth in the statement of the insurer's president on the faith of which the policy was issued or different from those prescribed in the by-laws."[2]

Where a bond was issued insuring an employer against any fraudulent conduct of an employee amounting to larceny or embezzlement in his position as bookkeeper, but in no other position to which he might be called, representations by the insured in his application for a bond, that the largest amount of money likely to be in the "risk's" hands would be but a few dollars, cannot be considered fraudulent or material, but should be treated as mere representations of intention.

"There can be no question," said the court in its opinion in this case, "but that the covenants of the bond covered such a loss as was sustained by the appellant. Its one purpose was to insure against loss that might result to appellant from the fraud or dishonesty of Weitkamp amounting to larceny or embezzlement whether the loss was that of money or other personal property belonging to the appellant or for which it might be responsible, or dishonesty which Weitkamp may have committed in the performance of his duties as book-

[1] H. S. & L. Ass. *v.* U. S. Fid. & Dep. Co., 197 Pa. 177; 46 Atl. 910.

[2] See also Am. Bond. & Tr. Co. *v.* Takahashi, *et al.*, 111 Fed. 125.

keeper, but also to such as he may have committed in any other position in appellant's employment to which he may have been appointed or called upon to fill. It is not material therefore, whether the fraudulent or dishonest acts of Weitkamp which caused loss of appellant were committed by the making of false entries in its books, by the raising of its checks or by abstracting money from its money drawer, nor is it material whether he was at the time acting as a bookkeeper or in some other capacity in appellant's service. Under either or under any of this evidence, appellee under the terms of the bond would be and is liable for the loss which he occasioned."[1]

In a late English case the policy provided that the "risk" (clerk of a city council) who had been appointed to carry out all the ordinary duties of his position should faithfully discharge the duties of his office and in particular should faithfully, honestly and punctually account to the council for all sums of money which he should receive while holding such office. It appeared that during the life of the policy certain work was being carried out by the council under the supervision of an engineer who received the money and paid the men. The engineer resigned and the "risk" later received the money for the purpose of paying the men, and misappropriated part of it. It was held that it was not part of the ordinary duty of the "risk" to make payments of this kind; that in giving the money, as it had, to the "risk" for the payment of employees the insured had increased his duties without the knowledge or consent of the insurer, and that in consequence the latter was discharged from liability under the policy.[2]

In Fidelity and Casualty Company *v.* Gate City National Bank[3] a policy was issued by which the insurer bound itself to make good to the insured to a specific extent "such pecuniary loss as the latter might sustain by reason of the fraud or dishonesty of the 'risk' in connection with his duties as

[1] Champion Ice & Cold Storage Co., 115 Ky. Ct. of App. 863; 75 S. W. 197; see also T. M. Sinclair & Co., Ltd. *v.* Nat. Sur. Co., 132 Ia. 549; 107 N. W. 184.

[2] Wembly Urban Dis. Coun. *v.* Pool Laws, etc. Guar. Ass., 17 T. L. R. 516.

[3] 97 Ga. 634; 25 S. E. 392.

receiving teller, or the duties to which, in the employers' service, he may be subsequently appointed or assigned." It was held that the insured had the right, without notifying the insurer, to confer upon the "risk" the office of assistant cashier in addition to that of receiving teller, and upon this being done, the insurer is as much bound to make good to the bank loss occasioned during the period covered by the policy by reason of the "risk's" fraud or dishonesty while acting in the capacity of assistant cashier as in that of receiving teller. In passing upon this question the court said:

> "In view of the comprehensiveness of the language of the policy, it would be difficult to hold that the insured was not a surety for the 'risk' in the capacity of assistant cashier as well as that of receiving teller. He was certainly appointed, subsequently to the execution of the bond, to the office of assistant cashier, as such had duties to perform in his employer's service, and by a violation of those duties brought loss to his master. We think the language of the contract covers the precise state of facts which arose, and that the insurer is as much bound to answer to the insured for the consequence of the 'risk's' dishonesty in the latter capacity as in the former."[1]

A case somewhat analogous to the foregoing is that of MacNichols *v.* Canadian Guaranty Company,[2] where it was held that a policy worded so as to clearly cover the defaults of an official assignee, covers those committed while acting under an unofficial appointment to that position by the consent and direction of creditors.

In another case the secretary of an insurance company gave a bond faithfully to perform his duties as such secretary, and to account for all moneys which should come into his hands in such position. On this state of facts it was held: first, that if the secretary was intrusted with the funds of the company, notwithstanding that it was also the prescribed duty of the president to receive the money paid to the company, and to deposit same, and he was responsible for any

[1] See also Am. Sur. Co. *v.* Pauly, 170 U. S. 133.
[2] 4 L. N. Can. 78.

failure of duty on his part, that did not relieve the secretary from responsibility for the faithful disposition of any funds confided to his care, the unauthorized act of the president in intrusting funds to the secretary could not discharge the secretary from the faithful preservation thereof; second, that the stipulation of the bond was an undertaking for the fidelity and honesty of the secretary commensurate with the scope of his duties, and the enumeration in the by-laws of certain things to be performed by him did not supersede this obligation which pervaded every department of his official functions. The insured had the right, under this stipulation, to insist upon indemnity for any deviation from the line of his duty to its prejudice.[1]

In an application to a surety company, it was stated in answer to the question as to the salary or compensation to be paid to the applicant that he was to receive $85 per month as salary or commission, while in fact he was to receive $10 a week and the use of a flat worth $20 a month and 2½ per cent for collecting rents amounting to about $100 a month. It was held that the answer was a valid statement of the applicant's earnings and was not deceptive or fraudulent.[2]

A fidelity bond was given by an agent conditioned upon the faithful performance of his duty to account for property delivered to him by his principal (the insured) and to assign invoices for sales thereof. It further provided that the insured should deliver bills of lading to the "risk" (the agent) only in trust to act as agent for the purpose of receiving and making a sale of the property represented thereby and that invoices of the sales should be immediately assigned to the insured. The court held that these conditions imported that the proceeds of the sales would be collected from the purchasers by the insured, and that its act in subsequently authorizing the "risk" to hold the property in trust for the purpose of selling it, upon his promise that he would deliver the proceeds of the sale

[1] Engler v. People's Fire Ins. Co., 46 Md. 322.

[2] City Tr., Safe Dep. & Sur. Co. v. Lee, Ill.; 68 N. E. 485.

within a fixed time, was such an enlargement of the liability assumed by the insurer as would, in case of a breach, release it from liability thereon.[1]

An insurance company employed a person as assistant superintendent of the thrift department in connection with its Wilmington agency. His duties were to procure agents to canvas and collect for the company. In January the defendant company insured the employer against loss by larceny or embezzlement by the employee. In April a new contract was made with the employer in which he was designated as "district manager" and "agent" and his field of operations made to embrace these accounts. It provided that all agreements previously made should be superseded, and that the employee should deposit with the insured a fidelity bond with two sureties. The first contract required a bond with only one surety. It was held that the April contract increased the business and territory in which the employee operated, and discharged the defendant from liability on its bond.[2]

In a recent Canadian case the court, in construing a fidelity insurance policy, wherein the question of breach of the condition now under consideration was involved, spoke as follows:

> "The questions and answers (in the proposal for a fidelity bond) may be divided into three classes as relating to (1) existing facts, (2) Young's future duties, (3) the company's future course.
>
> "Misstatements and omissions of existing facts are specifically dealt with in an express condition. So also is a change of employment having the effect of making the material facts different from the written proposal. It may be possible to treat the expression 'change of employment' as covering a change in the duties of the employee not involving his employment in a different capacity, but an alteration in his contract with the company. Even so, the company cannot be treated as having contracted for his strict performance of his duties. The utmost obligation that could be laid upon the company whether by virtue of the contract or in equity would be that it should expressly

[1] Tradesmen's Nat. Bank of the City of N. Y. v. Nat. Sur. Co., 169 N. Y. 563; 62 N. E. 670.

[2] Sun Life Ins. Co. v. U. S. Fid. & Guar. Co., 130 N. C. 129; 40 S. E. 975.

or by tacit concurrence assent to an alteration in the duties set out in the proposal. I doubt if information, knowledge and passive endurance of his breach of these duties in evidence constituted a concurrence therein so as to defeat the obligation, and not amounting to notice of an act of fraud or dishonesty, would not serve to relieve the surety."[1]

§ 92. (B) **Conditions providing that if any Material Change shall occur or be made during the Term of the Policy with Respect to the Method of checking the "Risk's" accounts or in reference to a supervision of the same by the insured as set forth in the Proposal for the Policy as theretofore made, then the Policy shall thereupon become null and void as to such "Risk."** — The foregoing condition closely resembles the one just preceding, and its general purpose is the same; that is, it seeks to transform a promissory warranty into a condition.[2] Such a condition as the foregoing should always be construed liberally by the courts, in favor of the insured.

Thus a condition of a policy providing that the "risk's" accounts should be checked and supervised in a particular manner, was held not to have been violated by the failure of the employee of the insured to carry out specifically his instructions in this respect.[3]

Thus a fidelity insurance policy indemnifying an employer against loss by reason of the fraud of an employee amounting to embezzlement or larceny provided that it was entered into on the condition that the statements in writing which the employer had delivered to the insurer relative to the duties of, and checks to be used on the employee, and that the statements and answers therein constituted the basis of the policy. One of the statements so made was to the effect that the employee's cash securities and stock were to be compared and verified with his accounts and vouchers twice a week. It

[1] Globe Sav. & Loan Ass. *v.* Emp. Lia. Assur. Corp., 13 Manitoba, 573.

[2] Young *v.* Pacific Sur. Co., Cal.; 137 Cal. 590; 70 Pac. 660; T. M. Sinclair & Co., Ltd. *v.* Nat. Sur. Co., 132 Ia. 549; 107 N. W. 184; see *ante*, § 80.

[3] Dougherty *v.* Lond. Guar. & Acc. Co., 6 Vic. L. R. 376.

was held that the failure of the employer to comply with the stipulations precluded recovery on the policy.[1]

In the case of Young *v.* Pacific Surety Company,[2] it was held that under Civil Code, § 2608, providing that a statement in a policy which imports that it is intended to do or not to do a thing which materially affects the risk, is a warranty that such acts or omissions shall take place, a statement in an application for indemnity insurance that insured should himself examine and audit the books and all moneys, securities, vouchers, etc., in the hands of his employee daily, constituted a warranty, and the failure to make such audit during the employer's absence from the city for four days during which a loss occurred, relieved the insurer from liability thereunder.[3]

In Livingston, *et al.* *v.* Fidelity and Deposit Company[4] the Ohio Supreme Court had occasion to consider the question now before us and in connection therewith spoke as follows:

> "Nor were examinations made of Blodt's accounts within the spirit of the contract of June, 1900, nor in the year 1901. It appears that one Diehm made some examination prior to June 1, 1900, and that an alleged expert examiner employed by the insured, but directed by Blodt, made an examination prior to December, 1900, and reported the accounts correct. No accounts were in fact rendered nor examinations had before June, 1900, as stated in the insured's last certificate. And it is entirely apparent that the examinations which were made, although probably conducted in good faith, were really perfunctory examinations and entirely untrustworthy. It is equally apparent that had the company exercised ordinary diligence or a real effort to comply with its contract with the fidelity company, the criminally loose methods of Blodt (the 'risk') and the grossly negligent methods of the other officers having duties in the management to perform, and which the spirit of the contract with the defendant company required that they should perform, would have been exposed years before the final catastrophe and before the certificate on which

[1] Wieder *v.* Union Sur. Co., 86 N. Y. Sup. 105; 42 Misc. 499; see also Fohs *v.* Rain, 39 N. Y. Misc. 316; 79 N. Y. Sup. 872.

[2] 137 Cal. 590; 70 Pac. 660.

[3] See also Guar. Co. of N. A. *v.* Mech. Sav. Bank & Tr. Co., 80 Fed. 766; reversed in 183 U. S. 402.

[4] 76 Ohio 253; 81 N. E. 330.

liability is claimed by plaintiffs was issued. In fact the active management appears to have been turned over to Blodt, who conducted affairs as he pleased without control, check, or efficient supervision by any one. Much of the time the vice president was out of the city, he and the treasurer having signed and left with Blodt blank checks, and all of the amounts converted were obtained by using these checks. The other officers seem to have been equally negligent. The vigilant supervision which the company, as well by its by-laws, the statutes of the state and its contract with defendant, was required to exercise, was wholly wanting."

§ 93. (C) **Conditions that the Policy shall become void from the Beginning if the "Risk" has within the Knowledge of the Insurer been a Defaulter at any Time during any Prior Service with the Insured or with Third Parties.**— The foregoing condition differs from the two that have preceded it in that it attempts to transform an affirmative warranty into a condition precedent. It seeks likewise to engraft into the law of fidelity insurance that principle of private suretyship which is so universal in its application, to the effect that the procuring of a bond covering the acts of an employee who has been guilty of previous dishonesty — such dishonesty being known to the employer and not to the obligor in the bond — constitutes such a breach as will relieve the obligor from any liability whatsoever under his bond. Such conditions are unquestionably valid, and any material violation thereof will serve to discharge the insurer from liability.

There can, however, be no knowledge within the meaning of the policy, if communicated only to a person in collusion with the "risk." [1]

One court of repute has held that the trial court did not commit material error in excluding in an action on a fidelity bond of a bank president, the certificate of the cashier (made in answer to an inquiry by the insurer) that the president had performed his duty in an acceptable and satisfactory manner, and that he knew of no reason why the fidelity bond should not be continued as requested by the insured. The

[1] Am. Sur. Co. *v.* Pauly, 176 U. S. 133.

assertion that the error committed was material, was based upon evidence tending to establish that the giving of the certificate was an act done in the course of the business of the insured. It was held that the exclusion of such certificate in evidence would not require reversal of a judgment against the "surety company" which issued the bond, where the jury were charged that if they could deduce from the evidence knowledge on the part of the bank of the previous dishonesty of the president, the surety company would not be liable. Here the fraudulent transactions of the president were not of such a character as to preclude as a matter of law, the possibility of a belief by the directors and other officers of the insured, as to the sufficiency of his explanations relative to his previous acts, which the insured claimed constituted a default.[1]

In American Bonding Company *v.* Spokane Building & Loan Association [2] an application for a policy of fidelity insurance had been made by a corporation in behalf of its secretary. This application stated that the latter derived his authority from the board of trustees. The Court held that knowledge on the part of a single officer, trustee or president of the corporation, that the secretary was indebted to it at the time the policy was issued could not be imputed to the corporation without proof that the officer's knowledge had been communicated to the Board, so as to constitute a breach of condition in the policy, which provided that if the "risk" was indebted to the insured at the time the policy was issued, that the latter should thereby become void.[3]

In a recent case [4] the court laid down the following rule, to wit: That recovery cannot be had on a bond insuring against loss by dishonesty of an employee where it is distinctly stipu-

[1] Fid. & Dep. Co. of Md. *v.* Courtney, 186 U. S. 342; 46 L. E. 193; same case below, 103 Fed. 559; 43 C. C. A. 331.

[2] 130 Fed. 737; C. C. A. 9th Cir.

[3] The doctrine of the text is fully sustained in Issaquah Coal Co. *v.* U. S. Fid. & Guar. Co., 126 Fed. 89.

[4] Model Mill Co. *v.* Fid. & Dep. Co. of Md., 1 Tenn. Ch. appeals 365.

lated both in the bond and in the application therefor that answers to questions in the application for such bond are to be taken as conditions precedent and as the basis of the bond applied for and if it appears that the answers to questions on material matters contained therein are untrue, though not known to the applicant to be untrue and even though there is no bad faith on the part of such applicant, yet such untruthfulness will suffice to void the insurer's liability on the policy. The court observed that:

"The court below had found that no bad faith was imputed to the employer in the statement made by him. That is, that there was no present purpose on his part to defraud the insurer, but it was known by the employer as a matter of fact that the 'risk' named in the bond was in default when the insured made the statements relative to the condition of the 'risk's' accounts at the time the bond was applied for."

"Now among these statements are these: 'In the first place it was said, which statement was warranted to be true, that Ingersoll's accounts had been examined in February, 1898, and were at that time in every respect correct, when, as a matter of fact, they had not in any just sense, as admitted by Mr. Bell, who was supposed to have examined them, been examined at all.'

"We do not deem it necessary to examine into or discuss the question as to whether or not the subsequent examination made after the statement was furnished would relieve the applicant from the results of the false statement. Inasmuch as the contract was made on the faith of the first statement, which was made on the 4th of November, 1898, we think this is a very doubtful proposition.

"But there are other statements which we think conclusive. Question 15 was as follows: 'Has he ever been short with you?' The answer was 'No.' Question 16. 'Is he now in debt to you?' Answer. 'He is not.' Now it will be noted that the question was not whether the examination had been made and that the auditing agent or committee had reported that he was not short, but here were the direct questions: 'Has he been short?' 'Is he indebted?' The answers to these questions were that he had never been short and that he was not in debt. As a matter of fact he was heavily indebted at the time. In a case heretofore presented and decided by this court upon certain statutory provisions, the representation was that a committee had examined the accounts. But in this case the applicant under-

took to state and in making the statement assumes to know that as a matter of fact the party insured had never been short and was not indebted. As we understand the nature and effect of this contract they took the risk of this statement being true. As plainly and expressly as it can be made to appear it was provided that these statements were the basis of this contract. It is clear at least that the statement as to whether or not Ingersoll had ever been short with the applicant was a very material statement. As we understand it, the parties by their stipulations had made it material and the basis of the contract and had made the truth of the statement a condition precedent to the recovery. If the statement had been that 'so far as we are informed Ingersoll is not and never has been short' that would have been an entirely different matter. Then it could well have been said that such a statement was true as it would appear that so far as the applicant company and its officers knew he never had been short. But no such statement was made. The parties saw fit to put the questions and answers in this positive and expressive shape and made it the basis of the contract. It was then made material by the stipulation of the parties and was as we think, as a matter of fact material in any event, and the statement being absolutely untrue, we think the condition upon which the defendant was to be made liable by the bond has failed, and the applicant is not entitled to recovery."

§ 94. (D) **Conditions to the Effect that any Wilful Suppression of a Material Fact by the Insured in any Statement or Declaration to the Insurer shall render the Policy void from the Beginning.** — The foregoing condition is closely connected with the subject of "concealment" in fidelity insurance law, and seeks to impose the duty upon the insured of stating all material facts known to him at the time the policy is issued upon penalty of releasing the insurer from any liability under the policy in case he fails to do so. Such a condition is classified as one in the nature of a warranty simply because there always exists an implied warranty that the insured, in his declarations or representations to the insurer, has acted at all times with entire candor, and is actuated with an intention to reveal to the insurer the truth, the whole truth, and nothing but the truth with reference to the "risk" whose faithful conduct in the employ of the insured is to be secured through the instrumentality of a policy of fidelity

insurance. In general, it may be stated that under such a condition as the foregoing it would seem as if little short of the grossest bad faith or fraud would suffice to affect the insurer's liability under the policy on the ground of breach of the foregoing condition. It has been claimed frequently, and sustained by courts of acknowledged eminence, that in respect to such matters as are here being considered, the insurer and the insured stand upon a plane of equal opportunity for information, and that the latter is not held strictly to the duty of voluntarily disclosing at his peril all matters material to the assumption of liability on the part of the insurer, even when required by the policy so to do, so long as in the discharge of said duty the insured acts in good faith and is not guilty of actual fraud.[1]

A case directly in point in this immediate connection is that of Issaquah Coal Company *v.* United States Fidelity and Guaranty Company.[2] In this case error was assigned on appeal, to the following instruction of the trial court to the jury, to wit:

"The court further instructs you, that the defendant in this action, by its written application in evidence, undertook to guaranty the fidelity of Mr. Bell as secretary and assistant treasurer, but did not undertake to guaranty his fidelity in any other capacity, and if Mr. Bell sustained any relation to the plaintiff in this action at the time the bond was written, other than that of secretary and assistant treasurer, it was the duty of the plaintiff to disclose such relation; and if you find from the evidence in this action that at the time the bond in question was written Mr. Bell was the sales agent of the plaintiff as well as the secretary and assistant treasurer, then I instruct you that it was the duty of the plaintiff to disclose that fact to this defendant. And if you find that Mr. Bell's position, and the fact of his being a sales agent added to his temptations or responsibilities in such a way as to increase the obligations of this defendant upon its bond, then I

[1] Guar. Co. of N. A. *v.* Mech. Sav. Bank & Tr. Co., 68 Fed. 459; 80 Fed. 766; 26 C. C. A. 146; reversed in 186 U. S. 402; Sup. Coun. Cath. K. of A. *v.* F. & C. Co. of N. Y., 63 Fed. 48; 11 C. C. A. 96; Ætna Life Ins. Co. *v.* Am. Sur. Co., 34 Fed. 291; Nat. Bank of Asheville *v.* F. & C. Co. of N. Y., 89 Fed. 819; 32 C. C. A. 355; Am. Sur. Co. *v.* Pauly, 170 U. S. 133.

[2] 126 Fed. 89.

instruct you that, as a matter of law, the defendant is released, and your verdict should be in his favor."

The court in approving the instruction as given in that case, made the broad holding that if in fact the officers of a corporation whose fidelity is insured sustains other relations to the company than indicated in its application for the policy, and which were essentially different, involving the receiving and expenditure of the employer's money, a failure to disclose such relations is a valid defence to liability on the part of the "surety company" under the policy.

Where a fidelity bond provides that any wilful misstatement or suppression of fact by the insured concerning the "risk" should render the bond void, the actual belief on the part of the insured's president that it was immaterial, whether the questions asked were material or not, did not render such answers immaterial.[1]

In Sherman *v.* Hardin,[2] the court spoke as follows:

"As contended by appellant, the obligee is bound to treat the surety in entire good faith and ordinarily upon discovering the employee's delinquencies, must notify the surety. But this rule has no application to cases of actual breach of duty or contract obligations on the part of the employee not involving dishonesty or fraud on his part nor fraud or concealment on the part of the employers. Had the money belonged to the association, then probably it must have advised the surety upon discovering Harbin's delinquencies; but even then it must have had actual knowledge thereof."

§ 95. (II.) **Conditions Precedent to the Creation of Liability under the Policy.** — The conditions above referred to may be classified as follows.

(A) Condition requiring the signature of some particular officer of the insurer to the policy before it shall become binding.

(B) Condition requiring the payment of the premium as a

[1] F. & C. Co. of N. Y. *v.* Bank of Timmonsville, 139 Fed. 101; C. C. A. 4th Cir.; see also Ætna Indemn. Co. *v.* City of Haverhill, 142 Fed. 124; C. C. A. 1st Cir.

[2] 125 Ia. 75; 100 N. W. 629.

prerequisite to the creation of the insurer's liability to the insured under the policy.

(C) Condition making the procuring by the insured from the "risk" of a contract to indemnify the insurer against any loss under the policy a prerequisite to the creation of any liability thereunder.

(D) Condition making the furnishing of suitable receptacles for the storage and protection of property belonging to the insured, and in the "risk's" possession or under his control, a prerequisite to the creation of liability on the part of the insurer under the policy.

§ 96. (A) **Condition requiring the Signature of Some Particular Officer of the Insurer to the Policy before it shall become binding.** — In the absence of any principle of estoppel, applicable to such cases, the insured is bound by any condition of its policy, making the signature of some designated officer of the insurer, essential to the attachment of liability under a policy of fidelity insurance. Such conditions are often inserted to prevent local agents of fidelity insurance companies from saddling their principals with greater liabilities than they are willing to assume.

§ 97. (B) **Condition requiring the Payment of the Premium as a Prerequisite to the Creation of the Insurer's Liability to the Insured under the Policy.**—It is frequently provided that no insurance, whether original or continuing, shall be considered in force until the premium is actually paid to the insurer, or as it is sometimes stated, such payment shall be essential to the currency of the policy and a condition precedent to the right to make a claim thereunder. With reference to such provisions as have just been referred to, it is sufficient to say that the same are unquestionably valid and are enforceable as against the insured, unless the insurer has in some manner estopped itself from asserting the validity of such condition.[1]

[1] See Rice *v.* Fid. & Dep. Co., 103 Fed. 427; 43 C. C. A. 270; Watrous *v.* M. V. Ins. Co., 35 Ia. 582; Fid. & Dep. Co. *v.* Libby, 72 Neb. 850; 101 N. W. 994.

In this connection it may be stated incidentally that it has been held that the failure to pay the agreed fee or premium to an insurer which issued a guaranty policy on an assignee in insolvency was sufficient ground for the removal of such assignee.[1]

In conformity with the foregoing principle it has been held that where a bonding company, with knowledge of an informality in the execution of the bond by its agent, receives and retains the premium paid for the bond, it is estopped in an action on the bond from urging such informality as a defence.[2]

Again, where a bond of indemnity does not stipulate how long it shall remain in force, but covenants merely that so long as it shall so remain the insurer shall be paid the annual premium in advance, this does not require the payment of the premium so as to continue the obligation, but leaves the insured at liberty to decline to make payment and thus put an end to the contract so far as the rights of third parties are not affected.[3]

In a late case bearing on this immediate subject it appeared that the insured had given a small note for a renewal premium which was subsequently paid by check payable to the insurer who cashed the check and retained the money. A renewal policy was issued reciting the receipt of the premium and in an action on the two policies the answer admitted the execution of the second policy. It was said that under the circumstances the insurer could not deny to the second policy the same effect as though the premium had been paid in cash at the time the note was given.[4]

The possession by the insured of the policy sued upon is

[1] Nelson *v.* Am. Sur. Co., 77 Minn. 402; 80 N. W. 300; see also F. & C. Co. *v.* Johnson, 72 Miss. 333; 17 Sou. 2.

[2] Farmers' & Mer. Ins. Co. *v.* U. S. Fid. & Guar. Co., Neb. ; 108 N. W. 156; see also Am. Bond. Co. *v.* Burke, *et al.*, 36 Col. 49; 85 Pac. 692.

[3] Fid. & Dep. Co. *v.* Libbey, 72 Neb. 850; 101 N. W. 994.

[4] Am. Cr. Ins. Co. *v.* Champion Coated Paper Co., 103 Fed. 699.

prima facie evidence of the payment of the premium, and upon a demurrer to the evidence is conclusive.[1]

In this connection attention is called to the case of Pacific National Bank of Tacoma,[2] where the court made the following holding:

Where a surety company delivers a bond guaranteeing the acts of a designated "risk," the insured may assume that the premium has been paid to the insurer, and the latter afterwards cannot be heard to say against the insured who has parted with value relying thereon, that the premium has not been paid, especially where there is no recital in the bond that the payment of the premium is necessary to give it validity.[3]

§ 98. (C) **Conditions making the Procuring by the Insured from the "Risk" of a Contract to Indemnify the Insurer against any Loss under the Policy a Prerequisite to the Creation of any Liability thereunder.** — It is sometimes provided that upon the insurer becoming liable under a policy for the acts of any "risk" the insured shall forthwith procure and deliver to the insurer an application for the policy from such "risk," embodying within it an express agreement on the part of said "risk" to indemnify the insurer in case the latter is compelled to pay out any moneys by reason of the issuance of a policy pursuant to such application.

As to whether a failure to procure such an application and indemnity agreement as has just been referred to would be in itself without any further steps on the part of the insurer sufficient to avoid the policy, it is somewhat difficult to say. The most that should be affirmed in this connection is that undoubtedly a notification on the part of the insurer to the insured prior to the incurrence of any liability under the policy, that unless the condition above referred to was complied with the insurer would cancel the policy within a certain designated time, and refuse to assume any further liability

[1] F. & C. Co. *v.* Chambers, 93 Va. 138; 24 S. E. 896.

[2] 33 Wash. 428; 74 Pac. Rep. 590.

[3] See *ante*, § 29; see *post*, § 198; see also Ætna Indemn. Co. *v.* Ryan, 53 N. Y. Misc. 614; 103 N. Y. Sup. 756.

thereunder, would be sufficient to relieve the insurer from any further liability under the policy until such indemnity agreement was furnished. Unquestionably the contractual right to obtain indemnity from the "risk" after payment of a loss is, together with the payment of the premium, the main inducement for the insurer's issuing a policy on any "risk." Therefore the procuring of a policy without the knowledge of the "risk" as evidenced by an application for a policy signed by the latter, considered in connection with the absence of any express agreement by the "risk" to indemnify the insurer, might deprive the latter of a valuable right.

The fact that the insurer might still have a remedy against the "risk" through the medium of the right of subrogation, in no wise impairs the value of the foregoing condition to the insurer. For the remedy by subrogation is by no means as full and complete as that afforded by an express contract of indemnity running from the "risk" to the insurer, as in the former case the right might be limited in its operation by reason of equities existing in favor of the "risk" as against the insured.

In Blackmore *v.* Guarantee Company of North America [1] the court had occasion to construe a policy containing a provision to the effect that it was essential to the validity of such policy that the "risk's" signature should be subscribed thereto. This signature was not procured, though the "risk" was named as one of the parties to the contract of insurance and in an action brought thereon by the insured against both the "risk" and the insurer, recovery was refused mainly on the ground of the insured's failure to procure the signature of the "risk" to the policy.

A fidelity bond for the indemnity of an employer against dishonesty of an employee issued on the application of the latter who paid the premium and by him delivered to the former, which contains on its face, in addition to the contract of indemnity, an undertaking of the employee to the insurer,

[1] 71 Fed. Rep. 363; 18 C. C. A. 77.

and a provision that it shall not be binding on the insurer unless signed by the employee, is not binding on the insurer unless thus signed, in the absence of any evidence showing that the signature of the employee had been waived by the insurer.[1]

Where a bond executed by an insurer of the fidelity of an employee, made it essential to its validity that the employee's signature should be subscribed thereto, but it was never signed by him, the bond was invalid, notwithstanding subsequent renewals, they being subject to all the conditions contained in the original bond, and though there was nothing in the bond to indicate that the insured and not the insurer was to procure the employee to sign the bond.[2]

In the words of the Maryland Court of Appeals:

"The indemnified cannot complain that there is any hardship inflicted upon it by holding the bond to be invalid by reason of the failure of its own employee to sign it, because it had possession of the bond and had control of its employee whose fidelity was guaranteed, and the failure to secure that employee's signature was due to its own omission or default alone. The indemnity company has the right to make the undertaking depend, as respects its validity, upon the condition that the indemnified's employee sign the bond. The condition was not unreasonable or illegal. The performance was within the power of the indemnified. The neglect or omission of the latter to comply with that condition precedent cannot be ignored when relied on by the indemnitor, and cannot give efficacy to an instrument which, by its unequivocal terms, was not to become operative until that specific condition was complied with. . . .

"The renewal receipts are explicitly declared to be subject to all the covenants and conditions contained in the original bond, and if the bond itself was inoperative by reason of the failure of the indemnified to have its employee sign it, the renewal receipts could not give it validity. The renewal receipts in terms reasserted the provisions of the bond and do not purport to continue the bond in force without reference to the conditions upon the observance of which its validity in the first instance depended."[3]

[1] U. S. Fid. Co. *v.* Ridgley, 70 Neb. 622; 97 N. W. 836.

[2] Adelberg, *et al.* *v.* U. S. Fid. & Guar. Co., 90 N. Y. Sup. 465; 45 N. Y. Misc. 376.

[3] Union Central Life Ins. Co. *v.* U. S. Fid. & Guar. Co., Md. ; 58 Atl. 437.

An instrument reciting a principal and signed by an alleged surety alone, the principal not signing it at all, is defective on its face and cannot be enforced against the surety in the absence of proof that he consented to its delivery in its incomplete condition.

It is undoubtedly true that one may bind himself for the debt or default of another without joining with him in the instrument the person for whom he becomes surety or guarantor. But where an instrument is drawn by which one person is to be bound as the principal obligor and the other is bound as surety, and undertakes that his principal shall faithfully discharge the terms of the obligation therein assumed by him, it is almost universally held that the surety cannot be held liable upon such contract, if it be not signed by the principal.

By many authorities such bond is held to be entirely void, while others hold that the obligee may enforce it by affirmatively showing that the surety consented to its delivery without the signature of his principal. Such an instrument shows its incompleteness on its face. The first glance at it reveals the absence of the principal party to the obligation, and puts the obligee upon inquiry as to the reason for its delivery in that defective condition. It avails nothing to say that the principal is bound to account for the funds in any event, for, whatever his implied liability by virtue of his fiduciary relation to the obligee, he is not bound by the bond which he has never signed, and no recovery can be made against him thereon.[1]

Where a bond given by the insurer of the fidelity of an employer provided "that it is essential to the validity of this bond that the employee's signature should be hereunto subscribed and witnessed," and at the end of the bond there was a place indicated for the signature of the employee but it was never signed by him, the bond was invalid notwithstanding subsequent renewals by renewal receipts declared to be subject to all the covenants and conditions contained in the

[1] Novak, *et al.* *v.* Pitlick, 120 Ia. 286; 94 N. W. 916.

original bond. In making this holding the court spoke as follows:

"The sole question in the case is whether the failure of the appellant's employee, whose fidelity was guarantied, to sign the bond of indemnity, prevented the bond from becoming operative and effective. Contracts of this character, like policies of fire insurance, to which they are closely analogous, though they are not strictly identical, must receive a reasonable construction so as to give effect to the intention of the parties hereto, and so as to carry out rather than defeat the purposes for which they were executed. They should neither on the one hand be so narrowly or technically interpreted as to frustrate their obvious design; nor on the other hand so loosely or inartificially as to remove the obligor from liability fairly within the scope or spirit of their terms.[1] If a recovery be permitted in this action it must be had in spite of the definite provision that the bond should not be binding unless signed by the employee whose fidelity it was intended to guaranty. The provisions which have been quoted above are declared in the bond itself to be 'conditions precedent to the right on the part of the employer to recover under this bond.' The liability of an indemnitor is measured by the contract into which he enters and is never enlarged by mere construction to include a term specifically excluded. Inasmuch as the indemnitor's liability is one dependent solely upon contract, it would be anomalous to hold that he is answerable under conditions directly contrary to the express stipulations of his undertaking. When he covenants to be bound provided certain antecedent conditions are complied with by the party indemnified, in the very nature of things, if these conditions are not fulfilled his liability never becomes fixed. This is so elementary that we do not pause to cite authorities in support of it. Giving to the bond of indemnity the most liberal construction contended for, treating it in point of fact as closely akin to a technical policy of insurance, we cannot understand how the indemnitor can be held accountable upon it in the teeth of the explicit covenants, that it should not be answerable unless designated provisions distinctly declared to be conditions precedent to the validity of the bond have been first complied with, when they have not been observed at all."[2]

A contrary holding was made in Ætna Indemnity Co. *v.* J. R. Crowe Coal and Mining Company.[3] The facts in this case briefly stated were as follows:

[1] Cr. Indemn. Co. *v.* Cassard, 83 Md. 276; 34 Atl. 703.

[2] Union Central Life Ins. Co. *v.* U. S. Fid. & Guar. Co., Md. 58 Atl. 437.

[3] 154 Fed. 545; C. C. A. 8th Cir.

The bond in controversy was a renewal bond. The original bond had been issued without the insurer requiring the execution by the "risk" of the bond in question. In other words, the execution by the "risk" of the original bond, issued by the insurer to the insured, was not made a consideration for calling attention to the creation of a liability by the insured, but the latter thereafter continued the bond which was not signed by the "risk" three times for further new considerations, subject to the conditions and covenants of the bond. Under these facts it was held that the surety company was not entitled to object that it was not liable under the last renewal because the bond was not originally signed by the "risk" as evidently contemplated under the terms and conditions thereof. On this point the court spoke as follows:

"Did the failure of Graves to sign the contract invalidate it? It seems to have been originally prepared with the intention of having him sign it, but for some unexplainable reason it was not done. While the contract is denominated a bond, it has few, if any, of the characteristics of a bond. It is essentially a contract of indemnity. Graves was not mentioned in it as principal but as an independent party. No reference was made to him in the body of the instrument, except in one case, which is to the effect that Graves will save the company harmless from any loss or damage it might sustain. Two separate and distinct contracts between parties appear to have been contemplated; one between plaintiff and the indemnity company, consisting of a contract of indemnity; and the other between Graves and the indemnity company, consisting of a contract of guaranty. In the former Graves was not concerned. The execution of the contract by Graves is in terms made neither a consideration for nor a condition of the creation of liability by the indemnity company. The bare fact that these two separate contracts were possibly originally intended to be incorporated in one writing, does not render them the less separable and distinct in their nature and purpose. Moreover if there were any doubt on the subject defendant subsequently adopted the instrument as it was actually signed as the contract between itself and the plaintiff. . . . These renewals, executed for a valuable consideration received and prepared by defendant, actually formed the original contract, notwithstanding the absence of Graves' signature, and estop it from asserting its invalidity when repeatedly so affirmed by it."

In Proctor Coal Company *v.* United States Fidelity and Guaranty Company,[1] the United States Circuit Court held that where a fidelity insurance company received premiums for two renewals of a bond with the knowledge that the bond was not signed by the "risk," whose fidelity was insured, as required by the terms of the bond, it was estopped to set up the absence of such signature to prevent a renewal of the bond.[2]

§ 99. (D) **Condition making the Furnishing of Suitable Receptacles for the Storage and Protection of Property belonging to the Insured and in the "Risk's" Possession or under his Control, a Prerequisite to the Creation of Liability on the Part of the Insurer under the Policy.**—The foregoing condition is not by any means a common one in the writing of the guaranty insurance policies. It is seldom found except in cases where the "risk" is engaged in some business either requiring long continued possession on his part of valuable property belonging to the insured, or where he is intrusted with the storage of grain, salt, coal and other commodities which are subject to loss, not only through acts of fraud or dishonesty on the part of the "risk" or third parties, but likewise from the action of the elements. Such a provision is inserted in policies as a proper and reasonable safeguard both for the protection of the "risk" and the insurer as well, and a failure to comply therewith might with justice be offered as a legal justification under the proper circumstances for a refusal to acknowledge liability under the policy on the part of the insurer.

§ 100. (III) **Conditions Precedent to the Maintenance of Continuous Liability under the Policy.** — The following may be enumerated as the principal provisions of fidelity insurance

[1] 124 Fed. 424.

[2] See also Playauer *v.* Am. Bond. Co., 92 N. Y. Sup. 238; Metropolitan Sur. Co. *v.* McDugall, 16 Pa. Dis. Ct. 952; North St. L. Bldg. & Loan Ass. *v.* Obert, *et al.*, 109 Mo. 507; S. W. Union Central Life Ins. Co. *v.* U. S. Fid. & Guar. Co., 99 Md. 423; see, however, in this connection Am. Bond. & Tr. Co. *v.* N. A. C. Co., 125 Ill. Ap. 33.

policies in the nature of conditions precedent to the maintenance of continuous liability under the policy.

(A) Condition making the consent of the insurer to any material change in the position of the "risk" necessary to maintenance of continuous liability under the policy.

(B) Condition making notification by the insured to the insurer of any information in his possession relative to the "risk's" being engaged in gambling or indulging in any disreputable habits or pursuits, necessary to the maintenance of continuous liability under the policy.

(C) Condition requiring immediate notice to the insurer by the insured of any act of the "risk" that may involve liability to the insurer under the policy.

(D) Condition relieving the insurer of any liability under the policy in case of condonation by the insured of any act of fraud or dishonesty on the part of the "risk."

§ 101. (A) **Condition Making the Consent of the Insurer to any Material Change in the Position of the "Risk" Necessary to the Maintenance of Continuous Liability under the Policy on its Part.** — The foregoing condition has already been considered under the general subject of promissory warranties.[1] The same purpose which is sought to be accomplished by way of warranty may be attained with at least equal success by inserting in the policy an express condition that if the "risk" is permanently assigned to perform other duties than those properly belonging to the position named in the policy, notice of such change of duty shall be given to the insurer in writing in order to effect a continuance of the latter's liability under the policy. The rule in regard to such changes, when made under the old time private surety bonds, was to enforce them with great strictness in favor of the surety.

The tendency, however, in the case of guaranty insurance policies seems to be towards a less strict application of the rule here referred to. Yet where changes are made by the insured which materially increase the responsibility of the "risk"

[1] See *ante*, § 88.

such changes have the effect in law to discharge the insurer from liability on its bond.[1]

In a Missouri case, plaintiff contracted with a printing company (the "risk") to print certain reports with paper to be furnished by plaintiff, the "company" to furnish a bond to indemnify plaintiff against loss by the misappropriation or misuse of any part of the paper so furnished. As a lot of papers were delivered, a written agreement was entered into by the plaintiff and the "company" whereby the latter acknowledged the receipt as bailees of the paper thus delivered and agreed to print and restore the identical paper as reports to the plaintiff as ordered, and so long as any part of the paper remained in the said company's possession, it continued to be the property of plaintiff. Before making such auxiliary agreements, the attorney in fact of the surety on the bond was notified thereof and asked if he had any objection to the terms and conditions therein contained, and he answered that he had not. It was held, that the original contract was not changed, nor the responsibility of the surety increased by such auxiliary agreements and the surety was not released thereby.[2]

A most instructive case in this immediate connection is that of Elgin Loan and Savings Association *v.* London Guarantee and Accident Company.[3] In the court below the controversy hinged upon the legal effect of a change of employment on the part of the "risk" named in a fidelity insurance policy. This change had been made by the insured without the insurer's consent. The lower court decided on the authority of Hay *v.* Employer's Liability Assurance Corporation [4] that the representation contained in the application for the policy relative to the duties of the "risk" constituted a mere declaration of intention. On appeal in this case the appellate court, reversing the lower court, spoke as follows:

[1] Sun Life Ins. Co. *v.* U. S. Fid. & Guar. Co., 130 N. C. 129; 40 S. E. 975.

[2] N. K. Fairbanks Co. *v.* Am. Bond. & Tr. Co., 97 Mo. App. 205; 70 S. W. 1096.

[3] 11 O. L. R. 330.

[4] 6 O. W. R. 459.

"Misstatements and omissions to reveal existing facts are specifically dealt with in an express condition. So also is a change of employment having the effect of making the material facts differ from those of the written proposal. It may be possible to treat the expression 'change of employment,' as covering a change in the duties of the 'risk' not involving his employment in a different capacity and as such not constituting an alteration in his contract with the insured. Even so, the insured cannot be treated as having contracted for his strict performance of his duties. The utmost obligation that could be laid upon the insurer whether by virtue of the policy or in equity, would be that it should expressly, or by tacit concurrence, assent to an alteration in the duties of the 'risk' as set out in the proposal. I doubt if information, knowledge, and passive endurance of his breach of these duties, as shown by the evidence, constituted a concurrence therein, not amounting to notice of an act of fraud or dishonesty, which would relieve the insurer from liability under the policy."

§ 102. (B) **Condition making Notification by the Insured to the Insurer of any Information in his Possession relative to the Risk's being engaged in Gambling or Indulging in any Disreputable Habits or Pursuits necessary to the Maintenance of Continuous Liability under the Policy.** — The foregoing condition has been fully considered in the case of Guarantee Company of North America *v.* Mechanics Savings Bank and Trust Company. This case was originally tried in the United States Circuit Court,[1] then appealed to the United States Circuit Court of Appeals,[2] and afterwards taken on writ of *certiorari* to the United States Supreme Court.[3]

Before presenting the opinion of the court of last resort in this case, it will be necessary to state some of the facts therein before quoting therefrom.

It appears that when one Schardt was about to be employed as cashier in a bank (after having been bonded as teller for some years) the president of this institution answered certain questions propounded to him by the "surety company" and warranted them to be true to the best of his knowledge and

[1] 68 Fed. 459.

[2] 80 Fed. 766; 26 C. C. A. 146; 100 Fed. 559; 40 C. C. A. 442.

[3] 173 U. S. 582; 183 U. S. 402.

belief. These questions and answers, so far as material to the present matter, were as follows:

"*Q.* Have you known or heard of anything unfavorable as to Schardt's habits or associations, past or present?" "*A.* No."
"*Q.* Or of any matters concerning him about which you deem it advisable for the company to make inquiry?" "*A.* No."

It appeared in evidence that Schardt was a heavy speculator. Within less than two years his losses amounted to more than $100,000. So imbued was he with the fever of speculation that he became a part owner of a "bucket shop," or brokerage concern. In the summer of 1892, during the time the last renewal of the teller's bond was in force, and before the issuance of the cashier's bond, Sykes, the then cashier of the bank, was informed of the conduct of the teller in this regard and at once notified Baxter, the president of the bank. Schardt was questioned on the next day and admitted that at one time he had been interested in such concern, but had sold out his interest. He also admitted that he had been speculating to some extent but had ceased to do so. Substantially the same things were stated by Schardt to Eatherly, a director and member of the finance committee of the bank. Some time thereafter and prior to January 1, 1893, when the cashier's bond was issued, Sykes, the cashier, received an anonymous letter again informing him that Schardt was speculating. This was also laid before the president of the bank. Eatherly also received an anonymous letter giving him similar information, which he showed to the president. In view of these facts it was claimed that the guaranty company was released on the ground of breach of the aforesaid condition of the policy issued by it to the bank upon Schardt as the "risk" therein named.

The policy specifically provided that the "insured should at once notify the insurer on his becoming aware of the said 'risk's' being engaged in speculation or gambling or indulging in any disreputable or unlawful habits or pursuits." It was

argued in behalf of the insurer that "both the letter and the spirit of the contract" were violated in this matter of speculation and bucket shop dealing on the part of the "risk" which were not reported to the insurer. The condition of the policy in this regard was claimed to be reasonable, having for its purpose the protection of the insured as well as the insurer.

The court in its opinion spoke as follows:

"The teller's bond, as originally given, expired January, 1889, and was renewed from year to year. Before each renewal the bank was informed by the company that it was necessary that a certain certificate by the president or cashier should be furnished, which was done, and stated, among other things, that the accounts of the teller had been examined, and verified by the finance committee of the bank. The bond provided that it was issued and renewed 'on the express understanding that the employee has not, within the knowledge of the said employer, at any former period, either in this or other employment, been guilty of any default or serious dereliction of duty;' 'that the employer shall observe, or cause to be observed, all due and customary supervision over the said employee for the prevention of default,' and that there shall be 'an inspection or audit of the accounts or books of the employee on behalf of the employer at least once in every twelve months from the date of this bond.'

"The company, not unnaturally, contends that as, when the bond was renewed in January, 1892, the bank's books showed that the employee was a defaulter in the sum of $19,600 under stated liabilities and of $3765.44 abstracted from bills receivable, both of which could have been detected by the taking of a trial balance as is customary, or a mere comparison between the books kept by Schardt and the individual ledger, and a correct footing of the notes, the bank had not only not complied with its engagements above referred to, and falsely certified to a verification which in fact had not been had, but was guilty of such laches as in itself to defeat a recovery. These are matters which, while not controlling our decision, should be considered in connection with that aspect of the case which we regard as decisive.

"In addition to the provisions already mentioned, it was agreed 'that the employer shall at once notify the company on his becoming aware of the said employee being engaged in speculation or gambling, or indulging in any disreputable or unlawful habits or pursuits.'

* * * "Whatever the common law duty on the part of the employer to notify the guarantor of the fraud or dishonesty of the employee whose fidelity is guaranteed, the parties to this contract undertook to declare the duty of the bank to the company in certain specified particulars. It required that the employee should not have been guilty of previous default or dereliction within the knowledge of the employer. It provided for notification of any act of the employee which might involve a loss without unreasonable delay after the occurrence of the act came to the knowledge of the employer. And it required immediate notification on the employer becoming aware of the employee being engaged in speculation or gambling. The words 'becoming aware' were manifestly used as expressive of a different meaning from having 'knowledge.'

"In Pauly's case,[1] where the bond required that the company should be notified in writing 'of any act on the part of the employee which may involve a loss for which the company is responsible hereunder, as soon as practicable after the occurrence of such act may have come to the knowledge of the employer,' it was ruled 'that it had been properly held that the surety company did not intend to require written notice of any act upon the part of the cashier that might involve loss, unless the bank had knowledge, not simply suspicion, of the existence of such facts as would justify a careful and prudent man in charging another with fraud or dishonesty.'

"But the bond before us not only contained that clause, but the clause under consideration, which was a different and additional clause intended to secure the safety of prevention through timely warning.

"It seems to us that the obvious meaning of 'becoming aware' as used in this bond, is to be 'informed of' or 'to be apprised of,' or 'to be put on one's guard in respect to,' and that no other meaning is equally admissible under the terms of the instrument. These are the definitions of the lexicographers, distinctly deducible from the derivation of the word 'aware,' and that is the sense in which they are here employed. It is used in the same sense in the cashier's certificate on the renewals of the teller's bond.

"To be aware is not the same as to have knowledge. The bond itself distinguishes between the two phrases and uses them as not synonymous with each other. And, in view of the plain object of the clause, we cannot regard the words as equivalent to 'becoming satisfied' though perhaps they may be to 'having reason to believe.' Even then these facts would have demanded investigation or notification, for we think the bank cannot be heard to say it did not have

[1] Am. Sur. Co. *v.* Pauly, 170 U. S. 133.

reason to believe that Schardt was speculating when it took his professions of repentance as sufficient assurance that he had ceased speculating, and turned its back on any independent inquiry or investigation. Our understanding of the provision is that what the company stipulated for was prompt notification of information by the bank in regard to speculation or gambling on the part of the employee. It was entitled to exercise its own judgment on that information and had not agreed to rely on the bank's belief in that regard. It had the right to investigate for itself, whether the bank did so or not. Notification of the existence of reason for inquiry was exactly what the clause was intended to secure. The bank neither investigated nor gave the company notice of the information it had, and substituted its own judgment as to the value of that information for that of the company. In our view this conduct on its part amounted to a breach of the stipulation.

"The Circuit Judge in his opinion said: 'The language of the bond is that the employer shall report on "his becoming aware of the employee being engaged in speculation." Without now stopping to consider at length the meaning of the terms here used, I am of opinion that, in the absence of fraud or bad faith, the failure to disclose the result of the inquiry made in this instance did not invalidate the bond as to the surety. Certainly speculation in a reasonable and substantial sense is meant, such in length of time or magnitude as would make it serious. This, when brought to the attention of the bank officials, was a past event, and apparently in itself unimportant. The bank was under no duty by the contract, or independently of it, to actively institute or prosecute inquiries about Schardt or to run down loose rumors or anonymous letters.' [1]

"The circuit court of appeals said: 'There is not the least evidence of any bad faith on the part of any of these officers of the bank, including Sykes, the old cashier, in not making a disclosure of what was known, but only of bad judgment in not being more considerably affected by their information.' [2]

"These quotations show that the circuit court of appeals and the circuit court concurred in the opinion that if the president and directors had such confidence in Schardt that they did not feel called upon to make any investigation in view of the information they had received, or to notify the company of that information, and were not guilty of intentional bad faith, then the bank could not be held to have violated the stipulations of the bond on its part.

"As will have been seen we are unable to accept this conclusion.

[1] 68 Fed. Rep. 459, 465.

[2] 47 U. S. App. 115.

The company's defence did not rest on the duty of diligence growing out of the relation of the parties, but on the breach of one of the stipulations entered into between them. The question was not merely whether the conduct of the bank was contrary to the nature of the contract, but whether it was not contrary to its terms. Engagement in speculation or gambling was what the company sought to guard against, because experience had admonished it of the probability that speculation or gambling would lead to acts involving loss for which it would be responsible. Bad faith, in the view of the courts below, would not exist if the bank had such confidence in Schardt's integrity that it accepted his bare statement that he was not speculating as overcoming the weight of his admission that he had been. How anything but such a denial could be expected it is not easy to see, nor how careful and prudent men could have been justified in omitting independent inquiry.

"The truth is, that, in spite of strict supervision and the pursuit of the best systems of keeping accounts, there is always a risk of defalcation. The prevention of defaults or their detection at the earliest possible moment are of even more vital importance to financial institutions than to guarantors of the fidelity of their employees. The provisions intended to protect the company in this case were not in themselves unreasonable, and so far as they operated to compel the bank to exercise due supervision and examination and due vigilance were consistent with sound public policy. We think it was the duty of this bank to have made prompt investigation or at all events to have notified the company at once of the information that it had, and we decline to hold that the bank's misplaced confidence in Schardt affords sufficient ground for enforcing the liability of the surety company on the theory of good faith.

"Our conclusion is that the failure of the bank in the particulars adverted to defeats a recovery on the teller's bond for defalcation after information of Schardt being engaged in speculation was received.

"It also results that there can be no recovery at all on the cashier's bond. If the bank had observed the stipulation in the teller's bond to which we have referred, it is obvious that there would have been no cashier's bond, and the question would not have arisen. But this it did not do, and the bond was given. The bond provided that the company covenanted with the bank in reliance on the statement and declaration of the president on behalf of the bank and on the bank's strict observance of the contract; that any misstatement of a material fact in the declaration should invalidate the bond; that the bank should use 'all due and customary diligence in the supervision of said

employee for the prevention of default'; 'that any written answers or statements made by or on behalf of said employer in regard to or in connection with the conduct, duties, accounts or methods of supervision of the said employee delivered to the company either prior to the issue of this bond, or to any renewal thereof, or at any time during its currency shall be held to be a warranty thereof, and form a basis of this guarantee or of its continuance.'

"Two of the questions and answers in this declaration were as follows:

"'*Q.* Have you heard or known anything unfavorable as to the habits, or associations, past or present?' '*A.* No.'

"'*Q.* Or of any matters concerning him about which you deem it advisable for the company to make inquiry?' '*A.* No.' In Pauly's case the president and cashier were confederates in the dishonesty of the cashier, for the purpose of defrauding the bank; and also it was held no part of the duties of the president, under the circumstances there disclosed, to certify to the integrity of the cashier as he did. In this case the dishonesty was that of the cashier alone; the statements were required to be made and were made on behalf of the bank, and the president acted for the bank in so doing; and the bonds were procured by the bank, and the bank paid the premiums. There can be no doubt that the bank was responsible for the representations of the cashier, in the one instance, and its president in the other, in procuring these contracts of indemnity. The representations made in the declaration on which the cashier's bond was issued were clearly misrepresentations. The teller's bond required notification if the bank were informed of speculation on Schardt's part. The president had heard of such speculation, and knew that speculating was something unfavorable as to Schardt's habits; and the president of course knew that the matters concerning him of which he had heard, were such as it was advisable for the company to make inquiry about. True, the second question was, if he had heard of matters about which he deemed it advisable for the company to inquire, and the word 'deem' might be said to give considerable discretion, but it was not a discretion to be abused. That the company would consider it advisable to make inquiry is too plain for argument. The whole tenor of the bond renders any other conclusion impossible.

"We cannot regard the representations of the president as consistent with good faith, and he was not even called as a witness by the bank to explain his conduct, if he could have done so."

In this connection it may be observed that statements made by one director of an insured corporation to another regarding

the "risk's" habits are immaterial where the kind of habits referred to were not disclosed.[1]

§ 103. (C) **Condition requiring Immediate Notice to the Insurer by the Insured of any Act on the Part of the "Risk" that may involve a Loss for which the Insurer is responsible under the Policy.** — The foregoing condition in most policies reads substantially as follows:

> "That the insurer shall be notified in writing at its home office of any act on the part of the 'risk' which may involve a loss for which it is responsible under the policy as soon as practicable after occurrence of such act shall have come to the knowledge of the insured."

The foregoing condition has been considered in a number of cases, some of which widely differ in the legal conclusions therein reached. Speaking generally, they may be divided into two classes, one adopting a broad construction, favorable to the insured, and the other interpreting such conditions strictly with a view to holding the insured to the express terms of the contract assented to by him when he accepted the policy. Turning now to the first line of decisions above referred to, attention is called to the case of the American Surety Company *v.* Pauly.[2]

The policy contained a provision to the foregoing effect. The Supreme Court of the United States, on the question of the proper construction of the clause of the policy requiring notice of acts that might involve a loss to the insured, quoted with approval the following instruction of Judge Wallace to the jury at the trial below:

> "Under that condition of the policy the defendant is entitled to notice in writing of any act of the cashier which came to the knowledge of the plaintiff of a fraudulent or dishonest character as soon as practicable after the plaintiff acquired knowledge. It is not sufficient to defeat the plaintiff's right of action upon the policy that it be shown that the plaintiff may have had suspicions of dishonest conduct of the cashier; but it was the plaintiff's duty under the policy, when it

[1] Perpetual Bldg. & Loan Ass. *v.* U. S. Fid. & Guar. Co., 118 Ia. 729; 92 N. W. 686.

[2] 170 U. S. 133; 42 L. E. 977.

came to his knowledge, when he was satisfied that the cashier had committed acts of dishonesty or fraud likely to involve loss to the defendant under the bond, as soon as was practicable thereafter to give written notice to the defendant. Now the written notice, the first written notice, was given on the 23d day of May, 1892. And in considering this issue you are to inquire first when it was that the plaintiff became satisfied that the cashier had committed dishonest or fraudulent acts which might render the defendant liable under this policy. He may have had suspicions of irregularities, he may have had suspicions of fraud, but he was not bound to act until he had acquired knowledge of some specific fraudulent or dishonest act which might involve the defendant in liability for misconduct. Now when was it he acquired such knowledge? A good deal of testimony has been introduced here upon that issue. After acquiring it, it was his duty, not as soon as possible to transmit information of it to the defendant, but to do it with reasonable promptness. He was not bound the first day or the next, necessarily to give notice, but he was to give notice within a reasonable time; and it is for you to say, upon a consideration of all the circumstances of the case, whether he did, within a reasonable time after acquiring such knowledge, send the letter of May 23d. It might be reasonable under one state of facts. It might be unreasonable under another. What might be very great diligence under one set of circumstances might be very dilatory under another. Now first, you are to determine when he really acquired the knowledge. I am not going to recapitulate the testimony. It is claimed upon his part that he did not acquire the knowledge until the close of the examination by the expert, and that was only within a day or two of the time of mailing the notice; and so testimony has been given to show that such examination commenced on the first of April and was continued until the latter part of May. On the other hand it is claimed that he must have acquired knowledge much earlier than this. Now there is a circumstance of some significance. It is hardly to be supposed that this receiver, holding an official trust, would retain in his employ a cashier after he had become satisfied that by the dishonesty or the fraud of that cashier the bank had sustained serious loss. He did retain him until the 2d day of March. And it may be that while he and those associated with him were entirely satisfied that there had been irregularities and even perhaps that there had been frauds on the part of the president they were not aware of any specific acts which could be designated as fraudulent or dishonest on the part of the cashier until the investigation had progressed for a considerable length of time. On the other hand, you have heard the plaintiff's

testimony as given in depositions taken in the West. Various extracts have been read, and it is insisted upon the part of the defendant that he must have known of these acts as clearly as the early part of February, 1892. Now, I charge you, as a matter of law, that if the facts were discovered in the early part of February and notice was not given until the latter part of May, that was not notice given with reasonable promptness. But if you come to the conclusion that the discovery was not made until the middle or latter part of May, then, in view of the situation of the plaintiff, you may reasonably come to the conclusion that he exercised proper diligence in sending the notice."

Commenting on these instructions, the supreme court said:

"We perceive no error in these instructions. They are entirely consistent with the terms of the contract. Much stress was laid in argument upon the words 'which may involve loss' in the above extract from the bond. But when those words are taken with the words in the same sentence, 'as soon as practicable after such act shall have come to the knowledge of the employer,' it may well be held the 'surety company' did not intend to require written notice of any act upon the part of the cashier that might involve loss, unless the bank had knowledge, not merely suspicion, of the existence of such facts as would justify a careful and prudent man in charging another with fraud or dishonesty. If the company intended that the bank should inform it of mere rumors or suspicions affecting the integrity of O'Brien such intention should have been clearly expressed in the bond. It was left to the jury to determine when the receiver first acquired knowledge of acts indicating fraud or dishonesty on O'Brien's part and they found in effect that he had no knowledge of any such act until after the report by the expert bookkeepers, made about or a few days before May 23, 1892. The trial court went far enough when it said, in response to an inquiry by a juror that notice given May 23, 1892, of a fraud by the cashier discovered as early as March 2 — the day on which O'Brien left the receiver — was not as soon as practicable after the receiver acquired knowledge of the facts."

Another case of value in this connection is that of the Fidelity Deposit Company *v.* Courtney,[1] where an action was brought by the insured (a bank) to recover on a policy given to indemnify the insured against loss by the fraudulent acts of

[1] Decided by the U. S. Sup. Ct., 186 U. S. 342; 46 L. E. 1193.

one J. M. McKnight, its president. Upon the subject of the duty of the bank under certain suspicious circumstances to notify the company thereof, that it might end its obligations under the bond, if it saw fit to do so, the trial court charged the jury:

"Now I suppose in this case if the bank had known that McKnight was making these drafts for these various fraudulent purposes, such as buying up councilmen, buying up aldermen, paying his own personal debts — if the bank had known that and consented to it, there would have been a fraudulent act by McKnight for which the bank could recover against this company. But if you believe, from the evidence, that the bank did not know of the fraudulent purposes for which the overdrafts were made, if the overdrafts were made in connection with this matter, if you believe the bank did not know of the fraudulent purposes, then that changes the result, because if the bank did not know and still consented to it, it would not relieve the act of McKnight from the character of being a fraudulent act. So that as I view the case (you must remember, however, that you are the sole judges of the evidence in this case and its credibility), as I view this case, however, there would be no fraudulent acts upon his part merely in an overdraft, if there were no fraudulent intent behind it, which was concealed from the bank."

The court of appeals in its opinion[1] spoke as follows:

"We think this instruction as favorable as the company was entitled to, and under it, if the jury found that the bank had knowledge that McKnight was doing the acts in question for fraudulent purposes, there could be no recovery upon the bond. We must remember that this obligation was intended to secure the bank against the fraudulent conduct of McKnight in the performance of the duties of his office or position; that McKnight's action, in order to require notice to the company, must have been 'of the discovery of a default or loss under the bond.' While McKnight might have been guilty of reprehensible conduct, it would not require notice, unless such as might result in the loss of security or money or personal property of the bank by fraudulent conduct in the performance of his duties to the bank. Such conduct as amounts to a default under the bond the employer is bound to report, and if he condones or continues the employee in his service, without written notice to the company, the latter would be discharged

[1] 103 Fed. 599.

from responsibility. Misconduct which would not amount to a fraudulent act affecting the duties of the officer of the bank would not require notice unless it came within that clause of the bond which requires the employer to notify the company when the employee engages in gambling or speculation or indulges in disreputable or unlawful habits or pursuits. Whether McKnight's conduct was of this character the court left to the jury to determine. They must have found that there was no such misconduct as would avoid the bond while the bank was in operation, and which it was the duty of the bank to report to the company. In this connection it is averred that the court erred in saying that this knowledge must be the knowledge of the bank, intending thereby to exclude the knowledge of individual directors. In the charge above quoted, as to the knowledge of the bank directors, we have already said we find no error. We have carefully examined the record, and find no knowledge brought home to the directors individually or to the cashier in his individual capacity, which was not brought to the attention of the board, which would amount to a default under this bond. Such knowledge, in order to be binding upon the bank, must have been acquired in the course of business of the bank transacted by such officer or director.

"The testimony shows no such knowledge of McKnight's conduct, acquired in the bank's business by individual directors or officers of the bank, and not known to the board, as would entitle the company to notice. As was said in Surety Company *v.* Pauly:[1]

"'It may well be held that the surety company did not intend to require written notice of any act upon the part of the cashier that might involve loss, unless the bank had knowledge, not simply suspicion, of the existence of such facts as would justify a careful and prudent man in charging another with fraud or dishonesty. If the company intended that the bank should inform it of mere rumors of suspicions affecting the integrity of O'Brien such intention have should been clearly expressed in the bond.'"

In affirming the decision of the trial court and of the court of appeals, the United States Supreme Court spoke as follows:[2]

"It follows that the notice was given within ten days to seventeen days after the first discovery of a default. Both the trial court and the circuit court of appeals, reviewing numerous authorities, held that the requirement in the bond 'that the employer shall immediately

[1] 170 U. S. 147; 18 Sup. Ct. 558; 42 L. E. 982.
[2] 186 U. S. 342.

give the company notice in writing of the discovery of any default or loss' ought not to receive the construction that it was intended by the parties that notice of a default should be given instantly on the discovery of a default, but that what was meant was that notice should be given within a reasonable time, having in view all the circumstances of the case. In so deciding we think the court did not err. Indeed, this construction of the word 'immediate' would seem to be applied in practice, as is illustrated by the bond of indemnity considered in the case of the Guarantee Company of North America *v.* Mechanics Savings Bank and Trust Company, 183 U. S. 402 *ante*, 25 Sup. Ct. Rep. 124, where one of the conditions was 'that the company shall be notified in writing of any act on the part of said employee which may involve a loss for which the company is responsible hereunder to the employee immediately or without unreasonable delay.'

"Whether the notices were reasonably immediate, — like the kindred question of what is a reasonable time, — are questions of fact that must be determined in the trial court.

"We think the trial court was right in refusing to instruct, as a matter of law, that the notice was not given as soon as reasonably practicable under the circumstances of the case, or without unnecessary delay, and in leaving the jury to determine the question whether the receiver had acted with reasonable promptness in giving the notice."

Under an employer's indemnity bond providing that the employer shall on discovery of any fraudulent act on the part of the bonded employee immediately give notice thereof to the indemnity company, the employer is not bound to report his suspicions to the "company," even though they are strong enough to justify, in his opinion, the discharge of the employee. But after suspicion is aroused, reasonable diligence must be used in pursuing inquiries as to the facts.[1]

The question whether the notice when given was timely is one for the jury.[2]

In Pacific Fire Insurance Company *v.* Pacific Surety Company [3] it was held that where the agent in California of an insurance company in New York under a contract requiring him to remit payments within fifty days from the end of the

[1] Fid. & Guar. Co. of N. Y. *v.* Western Bank, 29 Ky. L. R. 639; 94 S. W. 2.

[2] Fid. & Guar. Co. of N. Y. *v.* Western Bank, 29 Ky. L. R. 639; 94 S. W. 2.

[3] 93 Cal. 7; 28 Pac. 842.

month in which they were payable, fails through tardiness and neglect, but with no wrongful intent, to remit the premium until within from sixty to one hundred and twenty days after the end of each month, and this action is acquiesced in by the company as a substantial compliance with the contract, failure of the company to give notice of such delay to the insurer indemnifying against losses caused by the agent's fraud or dishonesty is not a breach of a condition of the bond, that the insured shall report to the insurer any act of omission or commission on the part of the agent that might involve a loss for which the latter is responsible thereunder.

The insured under a fidelity bond is not required to aid the insurer in determining the desirability of the contract of indemnity nor to warn him against risk where all the facts are as accessible to the one as to the other, whether the insurer be present or absent, unless the circumstances of the case are such that silence on the part of the insured would amount to an intentional deception or fraud.[1]

Where a surety company sent an inspector to ascertain the nature and extent of the delinquencies of an employee it had appointed, and such inspector assisted in an examination of the "risk's" books by an expert accountant, the surety company was charged with notice of what was going on, and likely to be ascertained, at least so far as to constitute waiver of notice of defalcations subsequently discovered until the examination had been completed, though the contract required "immediate notice." It was also held that the inspector of a surety company could waive notice of the employee's defalcations though prohibited from so doing by his contract with the insurer.[2]

On this same subject the court in Ætna Life Insurance Company *v.* American Surety Company[3] spoke as follows:

[1] Sherman *v.* Harbin, 125 Ia. 175; 100 S. W. 629.

[2] Perpetual Bldg. & Loan Ass. *v.* U. S. Fid. & Guar. Co., 118 Ia. 729; 92 N. W. 686.

[3] 34 Fed. 291.

"The next question of fact relates to the non-disclosure to the defendant (the insurer) of Patrick's (the 'risk') remissiveness in not making returns. The obligation of the defendant (the insurer) was to pay to the plaintiff any pecuniary loss which it had sustained during a specified time by any act of fraud or dishonesty on the part of Patrick in connection with his duties as agent. The plaintiff (the insured) was obliged to promptly notify the defendant of any act of omission for which the company is responsible hereunder. It cannot be supposed that this provision calls upon the employer to notify the defendant of every act of laches or delay or inefficiency on the part of the agent which ultimately may create a loss to the employer. It means that the defendant shall be notified of acts which may create a loss for which it is responsible, that is, a loss arising from fraud or dishonesty. It is not necessary to undertake to define affirmatively what kind or class of acts must be communicated and whether or not this obligation compels the employer to notify the defendant of that kind of conduct of the employee outside of his business, which experience has shown may probably result in dishonesty. It is sufficient to say that mere laches or inefficiency of the employee in the business which is consistent with integrity were not required to be communicated. This defence involves the question whether the plaintiff knew or had adequate reason to know from August to November that Patrick was a defaulter. I am by no means certain that the plaintiff is not to be charged with the duty of communicating, during the life of the bond, facts which it did not know, but which by the exercise of due diligence it could have known. Assuming that such an obligation rested upon the employer, the question whether its officer ought to have known of Patrick's defalcation depends in a great degree upon the same considerations which have heretofore been stated in regard to their knowledge on June 15 (the date the policy was issued). Greater vigilance or a larger clerical force would have caused the investigation which Webster (the vice-president of the insured) made on October 1, to have been made earlier and would have earlier sent an examiner to St. Louis, but a demand of that grade of vigilance on the part of the employer would speedily result in a cessation of business on the part of the defendant. The conduct of Patrick in not remitting was equally consistent with great remissness in collecting or with a lack of integrity. The vice-president evidently did not adopt the theory of want of integrity. I do not find that the plaintiff had knowledge of such circumstances as to compel a knowledge of Patrick's default prior to December 4, when the superintendent visited St. Louis."

In Bank of Tarboro *v.* Fidelity and Deposit Company of

Maryland[1] a somewhat different principle from any that has already been given is presented. Here it was said that the insured is not required to give notice of acts that may involve loss under a policy of fidelity insurance upon mere suspicion that the "risk" is guilty of defaults. It is only when it has actual knowledge of such facts as would justify the charge of default against the "risk" that notice to the insurer thereof must be given. In this connection it was asserted by the court that the insured is always entitled to a reasonable time in which to investigate the condition of the "risk's" accounts, if such investigation be necessary to ascertain the facts which would justify the charge of fraud or embezzlement. The insured is not required to act upon mere suspicion in preferring so grave a charge as fraud or embezzlement.

We come now to a consideration of the second line of cases referred to above in this immediate connection. The first of these is that of California Savings Bank *v.* American Surety Company.[2] Here attention was called by the court to the fact that the policy in suit therein expressly provided that the insurer "should be notified in writing at its office in the city of New York, of any act on the part of the 'risk' which may involve a loss for which the company is responsible hereunder, as soon as practicable after the occurrence of such act should have come to the knowledge of the employer." The fraudulent acts of the "risk" were discovered by the insured within six months next after March 7, 1892, and yet the written notices of such acts was not given to the insurer until December 16, 1895, more than three years after the time within which, according to the terms of the bond, it should have been given. The question before the court had reference to whether this was such a failure of performance on the part of the insured as would defeat a recovery by it under the policy in suit.

In disposing of this question the court spoke as follows:

"The insured contends that the requirement of the policy as to notice was 'formal,' that is, 'immaterial.' Notice of the fraudulent

[1] 128 N. C. 366; 38 S. E. 909.

[2] 87 Fed. 118.

acts of an employee involving a loss is quite a different thing from proof of the loss; and, as shown by the terms of the contract in the case at bar, the parties themselves deemed such notice 'material,' although they may have intended otherwise as to proof of loss. With reference to the latter, — that is, proof of loss, — the policy merely provides that the company's liability shall accrue ninety days after the proof has been furnished; and this provision according to many authorities does not require proof to be furnished within any particular period but merely postpones the right of the action until such proof is furnished. Notice, however, of the fraudulent acts of the employee, is placed upon an entirely different footing. The contract or policy provides that such notice shall be given as soon as practicable after the occurrence of the fraudulent acts comes to the knowledge of the employer, and the importance, the materiality, of prompt notice, as a matter of protection to the company, is clearly suggested in a subsequent provision of the policy as follows:

"'That the employer shall, if required by the company and as soon thereafter as it can reasonably be done, give all such aid and information as may be possible (at the cost and expense of the company) for the purpose of prosecuting and bringing the employee to justice, or for aiding the company in suing for and making effort to obtain reimbursement by the employees or his estate, of any moneys which the company shall have paid or become liable to pay by virtue of this bond.'

"Against the proposition that notice is material, plaintiff quotes as follows: 'In case of loss upon an insurance against fire, an insurer is exonerated, if notice thereof be not given to him by some person insured or entitled to the benefit of the insurance, without unnecessary delay.'[1] The insured's argument is that, because the provisions of this section are limited to fire insurance, therefore under the maxim, *expressio unius*, etc., the failure to give notice without unnecessary delay in the case of any other kind of insurance does not exonerate the insurer, and, consequently, that in all other kinds of insurance policies the requirements as to notice of loss, etc., are immaterial provisions. This last part of the argument, as shown in defendant's reply brief, is a *non sequitur*. Said section does not purport to construe or deal with contracts which expressly require notice to be given, but it makes notice obligatory upon the insurer, in fire insurance, where the contract fails to provide therefor. Whether or not in other kinds of insurance notice is essential depends upon the contracts which the parties make. Said section, however, does emphasize, in the strongest possible manner, the materiality of notice in the case of fire insurance; and it

[1] Civ. Code Cal., § 2633.

is believed that in fidelity insurance, which is of recent origin, notice of the fraudulent acts of the employee is of equal, if not greater, importance, for the reason that prompt notification may often enable the insurer to avoid, or secure indemnity for losses which otherwise would be inevitable or irremediable.

"The allegation of the complaint that the defendant was in the month of May, 1892, advised and informed of the breaches of the bond and the loss resulting therefrom, do not, in my opinion, excuse plaintiff's failure to give the prescribed written notice of the fraudulent act of the employee, and said failure is such non-performance of the contract on the part of the plaintiff as to defeat its recovery."

Again, in Michigan Savings and Loan Association *v.* Missouri, Kansas and Texas Trust Company[1] the "risk" was local agent for the insured at Denver, Col., and appropriated $1000 of his employer's funds to his own use. The policy was executed February 2, 1891, and provided that the insurer should make good to the insured "any loss which it might sustain because of any misconduct or misappropriation of the 'risk.'" The evidence showed that on July 1, 1891, the insured became aware of the defalcation of the agent and made repeated and futile attempts to get the "risk" to settle, and finally on December 18, 1891, gave notice to the insurer of the "risk's" embezzlement. The defence was that the insured did not give due and timely notice of the "risk's" misconduct. The policy provided that "as soon as any act of omission or commission on the part of the 'risk' tending to fix a liability on the part of the insurer shall come to the knowledge of the insured, the former should cease to be liable under the policy for any future act of the 'risk' in said employment, and it shall be the duty of the insured at once to notify the insurer in writing of said act and to make its claim for any loss from any of said acts within six months after the same shall have been discovered; and on failing to give such immediate notice, or to make such claim within the said time, the policy should be void." The court, in sustaining the said defence, spoke as follows:

[1] 73 Mo. App. 161.

"It must be seen that the insured so delayed giving notice to the insurer of the 'risk's' misconduct as clearly to bring the case within the conditions above quoted. The insured came to the knowledge of the 'risk's' misappropriation of the money in his charge six months before he notified the defendant company thereof. This was a clear violation of the terms of the policy which required immediate notice in writing to the insurer. This was a reasonable condition of the contract and must be enforced according to its terms, which are that upon the insured's 'failure to give such immediate notice, that then the policy shall be void.'"

Again attention is called to the case of Supreme Ruling of Fraternal Mystic Circle *v.* National Surety Company.[1] The facts in this case, briefly stated, were as follows:

A fidelity bond to indemnify an employer against loss by reason of the dishonesty of its employees required the employer, on acquiring information indicating that an employee was dishonest, to notify the insurer thereof, or the insurer would be relieved from liability in case an employee collected money for the employer. Under the rules of the employment the collection should have been remitted and reported September 2. The employee failed to do so. The employer in the latter part of September wrote to the employee, who thereafter replied that he would get the money and send it as soon as possible. The employer gave no notice to the insurer of the default of the employee until October 7. Thereafter the employee sent to the employer a check for a part of the collection, which check went to protest and was not paid. No notice of this fact was given to the insurer. The employee was allowed to make further collections which were not remitted. Thereafter the employer reported that the employee was delinquent. It was held that the insurer was not liable for collections made after August, the employer failing to give the required notice after being aware of the employee's failure to pay the collections made in August.

Another New York case bearing on this question is that of National Discount Company *v.* United States Fidelity and

[1] 99 N. Y. Sup. 1033; 114 App. Div. 689.

Guaranty Company.[1] In that case the court made the following holding:

Under an indemnity bond insuring a corporation against larceny or embezzlement by an employee and stipulating that the insurer shall be given written notice immediately after the occurrence of an act indemnified against shall come to the employer's knowledge, where a secretary and director of a corporation had knowledge on November 19 of an embezzlement by the employee and did not notify the insurer until December 7, such knowledge of the secretary was the knowledge of the corporation, and his neglect was a failure to perform a condition precedent to a recovery on the bond.

There seems to be no well settled rule on this subject either in England or Canada. In proof of this statement, attention is here called to a number of cases bearing on this question, decided by English and Canadian courts. In Ward *v.* Law Property Assurance Society[2] a guaranty policy against the criminal conduct of the insured's servants from May 7 for one year thereafter had been issued. It was provided therein that the insured was to give notice in six days after any liability had been incurred on the policy; on the 17th day of May after the expiration of the policy, the insured heard of an embezzlement by a servant who received each week large amounts trusted to his care, and it was held that the above words, "any liability had been incurred," by the insurer meant that it might be clearly responsible for, and if it were not clear that the insured would have been liable had the default been committed before May 7, he might properly examine in order to find out whether it had been committed after or before May 7.

In another case where the policy stipulated that the books should be kept in a certain manner and would be so kept, and that immediate notice be given the insurer, upon the employers' ascertaining the fact of any criminal offence entailing, or likely

[1] 94 N. Y. Sup. 456; 47 Misc. 611.

[2] 4 W. R. 605.

to entail, loss to the employers, and for which a claim was liable to be made under the policy, and the evidence showed no proper supervision of the books and that the insurer was not notified of a loss until a week after the employee's defalcation and after he had left the country, a recovery was refused.[1]

But a condition in a policy of guaranty insurance that the insured should, within ten days after discovery of any fraud or dishonesty of the employee whose honesty was insured, give notice to the company and send as far as possible an account of the particulars, and that the insurer should not be liable for any fraud subsequently committed, was held to be intended as the basis of a claim, and not as a condition compelling the insured to notify the insurer of a fraud that had occurred prior to the issue of the policy or committed by the employee under another employment.[2]

Where a policy required the insured to give notice immediately of any offence of the "risk" whose good conduct is insured, entailing loss for which a claim might be made under the policy, and the insured knew of a defalcation on the 25th of the month, but did not give notice of it until two days later when the employee had fled the country, it was held that the notice was not given in time.[3]

In Commercial Mutual Building Society *v.* London Guarantee and Accident Company[4] it was said that where the insured has stipulated to immediately notify the insurer of irregularities in the "risk's" accounts that failure to do this will relieve the insurer from liability under the policy. In this particular instance a defalcation was discovered on April 6, and notice was not given until April 17, when the employee had left the country.[5]

[1] Harbor Commissioners *v.* Guar. Co. of N. A., 22 S. C. R. (Can.) 542; 30 Can. L. J. (N. S.) 215.

[2] Byrne *v.* Muzio, L. R. 8 Ir. 396.

[3] Molson's Bank *v.* Guar. Co. of N. A., 4 Mont. L. R. (Sup. Ct.) 376.

[4] 21 Rev. Leg. 275; 7 Mont. L. R. Q. B. 307.

[5] See also generally Mut. Bldg. & Home Ass. *v.* Fid. & Dep. Co. of Md., 23 Sou. 405; 50 La. 291.

§ 104. (D) **Condition Relieving the Insurer of any Liability under the Policy in Case of Condonation by the Insured of any Act of Fraud or Dishonesty on the Part of the "Risk."** — The condition above referred to is found incorporated in fidelity insurance policies in many forms, of which the following is as good an example as any which might be given, to wit: "That if the insured shall at any time during the currency of this policy condone any act of default on the part of the 'risk' which would give the insured the right to claim thereunder and shall continue the 'risk' in his service without notification to the insurer of such condonation, the said insurer will not be responsible hereunder for any default which may occur subsequent to such act or default of said 'risk' so condoned." The foregoing condition was considered at length in the case of the Fidelity and Casualty Company *v.* Gate City National Bank,[1] where the doctrine of "constructive notice" on the part of the insured of acts of fraud or dishonesty on the part of "risk" is expressly repudiated.

Here the Fidelity and Casualty Company undertook by its policy to make good to the Gate City National Bank such pecuniary loss, not exceeding $10,000, as it might sustain by reason of the fraud and dishonesty of one Lewis Redwine in connection with his duties as receiving teller, etc. The main question in this case was whether or not, under the stipulation expressed in the contract, the knowledge of the bank's cashier of fraud and dishonesty on the part of Redwine or of any act done by him involving a loss to the company of more than $100 was imputable to the bank itself. The court, in its opinion, spoke as follows:

"This case does not fall within the general rule applicable to banks in their dealings with the general public. Much of the bank's business is necessarily intrusted to its subordinate officials or servants and in a large number of instances it will, upon the doctrine of constructive notice, be held to know what comes to their knowledge. This rule is founded upon necessity, and has for its object the protection of those

[1] 33 L. R. A. 821; 97 Ga. 634; 25 S. E. 392.

who deal with and trust the bank. The transaction out of which this bond grew was of an altogether different kind than those usually occurring between the bank and its customers. The contract was not made for the purpose of protecting the company in any dealings it might have with the bank, but, on the contrary, the company undertook to protect the bank in the matter of delegating some of its duties it owed to others to Redwine for performance in its behalf. In other words, the company agreed to save the bank from loss to a limited extent by reason of its thus trusting Redwine. And as naturally incident to a contract of this nature the company stipulated that the bank should gain no benefit thereunder if it continued in its service an employee known to be unworthy of trust without prompt notice to the company after he had been discovered by the bank to be untrustworthy. There is not a syllable in the contract, however, bearing the construction that the bank should exercise any degree of diligence in inquiring into or supervising the conduct of Redwine in order that the company might be saved from loss through his misconduct. The bank did not undertake to exercise reasonable care and diligence to find out if Redwine had become untrustworthy, but as to this matter the company in effect invited the bank to repose in peace, for it guaranteed that Redwine would remain honest and faithful. Only after knowledge had actually come to the bank that he was or had become otherwise was it under any duty to the company, and then it was only required to immediately notify the company of what it had ascertained. This bank, it seems, was conducting its business in the manner usual with such institutions, having a cashier, assistant cashier, receiving and paying tellers, bookkeepers, etc. It was not, so far as the company was concerned, under any duty to keep itself informed of the conduct of Redwine. The company must have known and contemplated that the bank's business was to be carried on through its employees, including Redwine, and yet it entered into a contract which does not even suggest that it should be protected if any of these employees other than Redwine should fail in the duties they undoubtedly owed to the bank of informing it of any misconduct on his part. Evidently the company chose to rely solely upon the care which the bank would most probably exercise in protecting itself, and consequently did not require any fixed supervision over Redwine; being willing to content itself with the assurance that the interests of the bank would necessarily require such supervision of him as would in all probability enable the bank to obtain actual knowledge of any fraud, dishonesty, or negligence of which he might be guilty. In the light of the foregoing considerations we cannot think that the parties to

this contract contemplated that the bank would be bound to act upon mere constructive notice of Redwine's shortcomings. The knowledge referred to meant actual knowledge. Constructively whenever Redwine — he being an employee of the bank handling its money — misapplied the same, the bank would have immediate notice of the fact, for his knowledge as a servant of the bank would, if the doctrine of constructive notice were applicable, be its knowledge. Surely the contract cannot be considered as contemplating any such knowledge as this. Again, suppose another employee was colluding with Redwine in concealing his shortage, the knowledge of such other employee would be constructively the knowledge of the bank. Or suppose Redwine and another employee, also under bond, were both misappropriating the bank's funds and each found the other out; could it be said in defence to a suit on Redwine's bond that the other employee's knowledge was knowledge of the bank, or when suit on the other employee's bond was entered, that Redwine's knowledge was constructive notice to the bank and the legal equivalent of the knowledge referred to in the company's bond? In the absence of any guaranty of the bank that its other employees would be honest and faithful, and in view of the purpose of the condition inserted in the bond, it would seem that the better construction of it would be that the bank only obligated itself to act in good faith and impart only actual knowledge on its part. The bond indeed would be of no practical protection, if in order to realize its benefit the bank had to insure not only the honesty and fidelity, but the faithful and conscientious attention to duty of the dozens others of its employees. Stupidity of an employee in not comprehending the effect of ordinary acts and circumstances, which would be equivalent to actual knowledge if within the knowledge of the bank itself, might lead to a forfeiture of the bond, while forgetfulness or mere negligent inattention to duty on the part of such employee would bring about the same result. The cashier, according to the undisputed testimony in this case, was a mere employee. Unless the bank obligated itself to use his eyes and ears, it had no knowledge of Redwine's conduct. . . . The doctrine of constructive notice has no application to transactions such as that in the present case. Not having required the bank to insure the fidelity of all its other employees as a condition precedent to recovery on Redwine's bond, the company cannot take advantage of the failure of duty on the part of one of the bank's employees. Undoubtedly it was the duty of McCandless, the cashier, to inform the bank as to any misdoings of Redwine which he knew. This was, however, a duty he owed to the bank and not to the company, which could only derive benefit therefrom by an

express stipulation in its contract to the effect that it should be entitled to have such duty of McCandless to the bank faithfully performed. The bank suffered from such neglect to a far greater extent than did the company, whose liability under the bond was limited in amount, and surely the bank is not equitably estopped from claiming the benefit under the bond which it had expressly stipulated for." [1]

Again, it should be observed that there can be no such thing as a legal condonation of dishonest acts on the part of the "risk" by the insured, where knowledge of such acts is held only by an officer of the insured, who is himself in collusion with such "risk." [2] However, there can be no question that when the insured has actual knowledge of acts of fraud or dishonesty on the part of the "risk" — and in the face of such knowledge continues him in his employ — that as to losses occurring thereafter no recovery can be had by the insured from the insurer under the policy. This not only because of the express conditions of the policy so providing, but as well on principles of equity and justice.[3]

In a recent case the Supreme Court of Iowa observed: [4]

"It will be noted that the employer is not bound to notify the surety company of the act of fraud or dishonesty when discovered. Failure to do so merely defeats recovery as to that particular claim. It is only when such discovery is followed by intrusting moneys, securities or personal property in the hands of the 'risk' or by condoning the act or making settlement privately with the 'risk' for any loss, that the contract becomes void."

A bond given to secure the faithful performance by an employee of his duties under a contract of employment dated February 11 bore the same date, but was not delivered until May 6. When first presented for signature the bond provided that it should "expire with the time of service as specified in the contract" (which time was not fixed, but

[1] See also Globe Sav. & Loan Co. v. Emp. Lia. Assur. Corp., 13 Manitoba L. R. 531.

[2] Am. Sur. Co. v. Pauly, 170 U. S. 133.

[3] See Fid. & Dep. Co. v. Courtney, 103 Fed. 599; 43 C. C. A. 331.

[4] Perpetual Bldg. & Loan Ass. v. U. S. Fid. & Guar. Co., 118 Ia. 729; 92 N. W. 686.

depended on mutual satisfaction of the parties), but before being signed it was changed so as to provide that it should "expire one year from the date thereof." It was held that the bond took effect as of the date of the contract and covered defalcations, if any, between said date and its delivery.[1]

In this same case it was said that the surety must specially plead in order to avail himself of the defence of a release by reason of the employer having made a contract with the employee permitting the latter to repay the money misappropriated by working a sufficient length of time to balance the same with his wages, or by reason of the imposition upon the employee of duties not contemplated by the contract and materially increasing the risk of the surety, or by reason of the employer having prejudicially retained the employee in the service after declaring his delinquency and concealing the situation from the surety.[2]

In the case of Remington *v.* Fidelity and Deposit Company of Maryland,[3] the facts were as follows: An employee's fidelity policy required that if the insured, with previous notice and consent of the insurer, entrusted the "risk" with money or property after discovery of his dishonesty, the policy should be forfeited. The insured discovered the defalcation of the "risk" (his bookkeeper) on August 20 of the year covered by the policy. His office was large and in such condition that he could find no one to take charge of the office, but he finally secured another bookkeeper, who could not report for several days. In the meanwhile he was called out of the city on business, and left the defaulting bookkeeper in charge, who, in his absence, forged several checks. Notice of the "risk's" dishonesty was sent to the insurer on October 3 of the same year. Under this state of facts the court held that the latter was not liable for any defalcations occurring after August 20th. In this case the

[1] Brillon Lumber Co. *v.* Barnard, 131 Wis. 284; 111 N. W. 483.

[2] *Idem.*

[3] Wash. ; 57 Pac. 989.

policy specifically provided that if the employer condoned in defaults of the "risk," for which the insurer might be liable, or should make any settlement with the "risk" for any such default, the policy should be forfeited. The "risk" turned over certain money and property to his employer (the insured), which were received by the latter, "for whom it might concern," and it was credited on the "risk's" account with the insured. It was held that this constituted a settlement and condonation within the meaning of the condition above recited.[1]

In Fidelity and Deposit Company of Maryland *v.* Courtney[2] the United States Supreme Court made a holding to the following effect:

That the knowledge of the vice-president and of one or more directors of a bank, but less than a majority of the board, of a default by the president, is not rendered imputable to the bank, so as to relieve a surety upon his bond from liability thereon, by the provision therein that the employer shall exercise due and customary supervision, and will not condone a fault of the bonded employee, or continue him in his employment after the commission of a default, as such provision relates to the bank, and not to a minority of the board of directors or its subordinate officers or agents.

The court also held, that in the absence of express agreement, the surety on a bond given to a corporation conditioned for the faithful performance by an employee of his duties is not relieved from liability for a loss within the condition of the bond by reason of the laches or neglect of the board of directors not amounting to fraud or bad faith, and that the acts of ordinary agents or employees of the indemnified corporation, conniving at or cooperating with the wrongful act of the bonded employee, will not be imputed to the corporation.

It appeared in evidence in this case that on June 1, 1894,

[1] See also Am. Bond. Co. *v.* Spokane Bldg. & Loan Ass., 130 Fed. 737.

[2] 186 U. S. 342; 46 L. E. 1193.

one McKnight was elected vice-president of the bank, and procured a guaranty policy for one year from that date. Upon June 1, 1895, he was elected president and the policy was then renewed, and was later again renewed for the further period of one year. In the petition in the case filed by the insured defaults aggregating $18,742 were set up. The answer of the insurer set up, among other things, as a defence to the action, that no notice of McKnight's defaults was ever given as required by the policy; that the bank did not observe due and customary supervision over McKnight; that the vice-president of the bank knew of the embezzlements of McKnight, and yet the insurer was not notified of the same until long after the bank was closed and a receiver appointed; that the receiver did not file his claim against said company until the 18th day of February, 1897; that this notice did not give the particulars of McKnight's defaults, and that defendant did not fully know of the same until the 2d of July, 1897; that Rudolph Reutlinger was teller and cashier, and as such had charge of such financial affairs as pertained to said offices; that Adolph Reutlinger was vice-president and was daily in the bank and thoroughly familiar with all its business and affairs, and with the acts and defaults of said McKnight as president; that the directors were also familiar with McKnight's overdrafts; that McKnight's defaults and embezzlements were known to the directors, who allowed them to go on without the knowledge of the Fidelity and Deposit Company; that during the time McKnight was in office the books were out of balance about $3000; that the directors and officers allowed McKnight to be constantly overdrawn in his personal account; that his overdraft January 18, 1896, was $1340.14, and on June 8, 1896, it was $626.23, and that day in and day out he was overdrawn, of which fact the directors had knowledge, and these irregular acts and defaults were not known to said defendant, otherwise it would have cancelled the policy; that before the renewal thereof, in 1895–96, it wrote the bank to ascertain if McKnight had been con-

ducting himself properly, and was informed by the cashier that McKnight had discharged his duties faithfully; that such statements were made with the knowledge of the directors, but that said statements were false and fraudulent, which at the time was unknown to said defendant; and that thereby the company was led to renew the bond, which otherwise would have been cancelled. When the case went to trial, testimony was offered tending to show various transactions of McKnight's in the course of his business in the bank; among other things the overdrafts of McKnight, and that checks were given by him and carried by the cashier as cash items, at the direction of McKnight, for a considerable length of time. There was also testimony tending to show that McKnight, while a candidate for office of mayor in the city of Louisville, which office was to be filled by the council of said city, obtained $1000 for one Edmunds in bills of $100 each, which money was obtained on Edmunds' check, he at the time having no account at the bank as an individual, but Edmunds & Co. had an account there. Edmunds testified he understood the check was to be taken care of by McKnight. It was also testified that a loan was procured of $2000 to Britt and Reeder, which money was obtained at the bank after banking hours, and that McKnight said he had a big scheme on hand, and it appeared this money was given for the purpose of obtaining an illegal contract with the councilmen as to possible legislation which might come before them. McKnight, on being asked for an explanation of the matter, claimed that it was all right; that the note was good; that the matter was brought before the board of directors, where McKnight made an explanation to the same effect, and that it seemed to satisfy the board. On this state of facts the court spoke as follows:

"As the rule of imputation to the principal of the knowledge of an agent does not apply to such a case, it must follow that it can only obtain as a consequence of an express provision of the contract of suretyship. Was there such a provision in the bond now under consideration?

"Now the clause of the bond sued on, and as to which the court was instructing the jury in the portions of the charge under consideration is as follows:

"'That the employer shall observe, or cause to be observed, due and customary supervision over the employee for the prevention of default, and if the employer shall at any time during the currency of this bond condone any act or default upon the part of the employee which would give the employer the right to claim hereunder, and shall continue the employee in his service without written notice to the company, the company shall not be responsible hereunder for any default of the employee which may occur subsequent to such act or default so condoned.'

"Manifestly, this stipulation is not fairly subject to the construction that it was the intention that the neglect or omission of a minority in number of the board of directors or the neglect or omission of subordinate officers or agents of the bank should be treated as the neglect or omission of the bank. The provision is not that a minority in number of the board of directors or that subordinate officers or agents would exercise due and customary supervision and would not condone a default of the bonded employee or retain him in his employment after the commission of a default, but the agreement is that the bank would do or not do these things. This in reason imports that the things forbidden to be done or agreed to be done were to be either done or left undone by the bank in its corporate capacity, speaking and acting through the representative agents empowered by the charter to do or not to do the things pointed out. To hold to the contrary would imply that the bond forbade the doing of an act by a person who had not power to perform or commanded performance by one who could not perform. Assuredly, therefore, the conditions embodied in the stipulation to which we have referred, both as to doing and non-doing, contemplated in the reason of things the execution of the duties which the contract imposed on the bank, either by the governing body of the bank, its board of directors or a superior officer, such as the president of the bank, having a general power of supervision over the business of the corporation, and vested with the authority to condone the wrongdoing or to discharge a faithless employee. That is to say, the stipulation in all its aspects undoubtedly related to the bank acting through its board of directors or through an official who, from the nature of his duties, was in effect the vice-principal of the bank."

§ 105. (IV) **Conditions by Way of Absolute Limitation on the Liability of the Insurer to the Insured under the Policy.** —

The foregoing absolute limitations to which reference is here made may be enumerated as follows:

(A) Conditions limiting the liability of the insurer to the insured to losses occurring during the life of the policy.

(B) Conditions limiting the liability of the insurer to the insured to all claims for loss discovered and filed within a certain designated time after the expiration or cancellation of the policy.

(C) Conditions limiting the liability of the insurer to the insured to all claims for loss filed within a certain designated period after the death, suspension, dismissal or retirement of the "risk."

(D) Condition limiting the right of the insured to make and file claims under the policy to a certain designated period after the insolvency of, or discontinuance of business by, the insured.

(E) Conditions excluding from the liability of the insurer to the insured all claims for money used by the "risk" within the period of liability to repay or refund moneys taken by the "risk" from the insured prior to the commencement of the insurer's liability under the policy, or prior to a designated period next before the time of giving notice to the insurer by the insured of a claim thereunder.

§ 106. (A) **Conditions limiting Liability of the Insurer to the Insured to Losses occurring during the Life of the Policy.**— The foregoing is usually found in the policy in the form of a provision, "that the insurer shall not be liable thereunder for any fraudulent act committed, or for any moneys or property misappropriated or not accounted for by the 'risk' prior to the date designated for the commencement of the policy." A case in point in this connection is that of Dorsey *v.* Fidelity and Casualty Company of New York.[1] Here the Fidelity and Casualty Company, as insurer, issued a guaranty policy on several employees of the insured, covenanting that during the continuance and force of the policy certain speci-

[1] 98 Ga. 456; 25 S. E. 521.

fied employees of the insured should faithfully and honestly discharge their duties in their several capacities, and also should faithfully and truly account for all moneys and property, etc. One of the employees, named in the schedule attached to the policy, made a wrongful delivery of freight, in consequence of which the insured was compelled to pay the value of such freight to its true owner, the wrongful delivery having occurred before the policy was executed. The court in its opinion says:

"It seems to me absolutely free from doubt that under the contract between the insurance company and the receiver it was never contemplated that the company should be in any manner responsible or liable for any breach of duty or misfeasance on the part of any employee of the insured which occurred before the policy was issued. The company simply undertook to guarantee the faithful and honest discharge of duties by the employees named in the bond from and after its date. The contract as to its operation related exclusively to the future, and not to the past. We do not see that it makes a particle of difference that one of these employees, in consequence of a past act of negligence, has become liable to the receiver, and is still liable at the termination of the employment to respond in damages to his master. This was a matter with reference to which the insurance company did not covenant with the insured, and there is no more reason for holding the company responsible for such damages than there would be in making a surety on a promissory note liable for a preëxisting indebtedness of his principal which the surety had never in any manner contracted to be or become liable for." [1]

§ 107. (B) **Conditions limiting the Liability of the Insurer to the Insured to all Claims for Loss discovered within a certain Designated Time after the Expiration or Cancellation of the Policy.** — It is customary to provide that in the event of the expiration or cancellation of a policy the right of the insured to make a claim thereunder shall cease at the end of ninety days next after the date of such expiration or cancellation. Such a condition as the foregoing was considered by the court

[1] See to the same effect T. M. Sinclair & Co. *v.* Nat. Sur. Co., 132 Ia. 549; 107 N. W. 184; Model Mill Co. *v.* Fid. & Dep. Co., 1 Tenn. Ch. App. Rep. 365.

in De Jernette *v.* Fidelity and Casualty Company of New York.[1] Here the discovery of the fraud or dishonesty of Ramsey, the "risk," was not made, according to the allegation of the petition, until the third day of May, 1893, and on the 20th of the same month notice thereof was given to the company. By the express terms of the policy, it was provided that within three months after such discovery as aforesaid, and within three months after the expiration of the bond, the employer shall give full particulars of any claim thereunder to the company. This was not done for more than three months after the expiration of the renewal of the bond and for more than one year after the expiration of the bond. In passing upon the question of the insurer's liability under such a state of facts, the court observed that "the company desired by these provisions to require vigilance on the part of the employer to discover and give notice of the fraud and dishonesty of the employed. It was of the utmost importance that this be done. The company could protect itself to some extent by having such information. It required and had the right to expect vigilance on the part of the employer. . . ."

"The evidence showed defalcations between January 19, 1891, and January 19, 1893, but knowledge thereof never came to the insured until May 3, 1893. The employer was guilty of gross negligence in failing to make a discovery of the fraudulent conduct of his deputy. Doubtless he was unaware of the terms of the guaranty bond, requiring him to make the discovery within a given time, still he is presumed to know its provisions and was bound by them. . . . The liability of the insurer for an act committed during a given period must be determined by the terms of the contract in force at the time of its commission, and a subsequent renewal does not extend the time for the disclosing of the wrong and the enforcement of the liability therefor. . . . The discovery must be made within three months after the expiration of the contract during the currency of which the act was committed."

In an English case a policy was issued, guaranteeing the insured against loss by the fraud of the "risk" which should be

[1] 98 Ky. 558; 33 S. W. 828.

committed and discovered during its continuance. The policy terminated at the end of one year, was subject to conditions precedent requiring immediate notice on the discovery of any fraud on the part of the "risk." It further provided that all claims should be made within three months after discovery thereof, and that it should only cover losses incurred within twelve months before notice of claim. It was held that the insurer was not liable for a fraud committed within the year but not discovered until after the expiration of the policy.[1]

§ 108. (C) **Conditions limiting the Liability of the Insurer to the Insured to Claims for Loss filed within a certain Designated Time after the Death, Suspension, Dismissal or Retirement of the "Risk."** — The customary provision of policies in this connection is to the effect that in the event of the death, suspension, dismissal or retirement from the position scheduled of the "risk" while in the employment of the insured, the right to make a claim thereunder as to such "risk" shall cease at the end of ninety days next after either of such events, whichever shall first happen. The foregoing condition has been many times before the courts for judicial construction. A leading case on this immediate subject is that of Lombard Investment Company *v.* American Surety Company,[2] the facts of which were as follows: The American Surety Company executed to the Lombard Investment Company four guaranty insurance policies for one year each, covering the years intervening between November 1, 1888, and November 1, 1892, and in each of these bonds one Russell was named as the "risk." Russell remained continuously in the employment of the insured until June 18, 1892, when he retired. The insured did not discover the loss occasioned by the dishonest acts of Russell until August, 1892. On August 26, 1892, a written notice was sent to the American

[1] Fanning *v.* London Guar. & Acc. Co., 10 Vic. L. R. 8; see also Com. Mut. Bldg. Soc. *v.* London Guar. & Acc. Co., 7 Montreal L. R. Q. B. 307; U. S. Fid. & Guar. Co. *v.* First Nat. Bank of Dundee, Ill. ; 84 N. E. 670; U. S. Fid. & Guar. Co. *v.* McLaughlin, *et al.*, Neb. ; 107 N. W. 577.

[2] 65 Fed. 476.

Surety Company of the loss resulting to the insured by reason of the embezzlements of Russell during the first, second, and third terms of the indemnity policies, the last of which losses occurred March 7, 1891. The policy provided that at the cessation of the "risk's" employment he should deliver over to his employer all books, documents, effects, money, etc., belonging to the latter. The court construed the term "cessation of employment" to mean the end of the term of twelve months named in the policy as the period of liability thereon, unless the same should be sooner ended. The policy further provided that the insurer should make good all loss occurring during the continuance of the policy and discovered during the said continuance or within six months thereafter, or within six months from the death, dismissal or retirement of the employee from the service of the employer. With reference to this clause the court said:

"The simple meaning of this clause is that the insurer shall be responsible for such defaults as may be discovered within twelve months' term, and if not so discovered before the first day of November, 1889, the end of the term, six months' grace is accorded for making of such discovery; or if the employee should die, or be dismissed, or retire from the service of the employer before the expiration of the term of twelve months, then within six months from the date of such death, dismissal, or retirement. Had the conditions of the bond stopped here, it would give color and force to the contention of the insured, that this would have been simply a covenant contract, which, under the state statute, would carry the right of action thereon over a period of ten years from the day when the right of action accrued.[1] But the contract contains this further provision: 'As a part of this bond, that no suit or proceeding at law or in equity shall be brought to recover any sum hereby assured, unless the same is commenced within one year from the time of the making of any claim on the company.'

"To make still more apparent the intent and meaning of the contract as to the time within which an action for default thereon might lie, the succeeding paragraph imposes certain duties upon the assured

[1] Rev. St. Mo. 1889, § 6774.

to entitle him to a right of action for any default. This provision is as follows: 'That the company shall be notified in writing, addressed to the president of the company, at its office in the city of New York, of any act or omission on the part of said employee, which may involve a loss for which the company is responsible hereunder, as soon as practicable after the occurrence of such act shall have come to the knowledge of the employer.'

"This paragraph does not stop at this point, but proceeds as follows: 'That any claim made in respect of this bond on said employee shall be in writing, addressed to the president of the company as aforesaid, as soon as practicable after the discovery of any loss for which the company is responsible hereunder; in case of death, dismissal, or retirement of said employee within six months thereafter; and in all other cases within six months after the expiration of this bond, as aforesaid, or within six months from the death, dismissal, or retirement of said employee.'

"From all of which it seems clear to my mind that a period of six months is accorded for the discovery of a default, after the expiration of the term of twelve months; and that in case of a default occurring within the term, and the employee shall die, or be dismissed, or voluntarily retire from service during the term of twelve months, notice and claim of loss must be made within six months after the event of death, dismissal, or retirement. There could be no dismissal or voluntary retirement of the employee save during the continuance of the term; and the term 'in case of death' must be known by its associates, and be interpreted in connection with the words 'dismissal or retirement,' and in consequence it means a death occurring during the existence of the twelve months' term, as there could have been neither sense nor meaning in making a provision respecting a death which did not occur during the term. The evident object of this provision was that, in case of death, dismissal, or retirement, which must occur inside of the twelve months' term, the period of the six months in which to make claim of loss should date from that event, and not from the first day of November, 1889, the end of the term of service under the contract; and if claim of loss, in case of death, dismissal, or voluntary retirement from service, must be made within six months from the event, the conclusion is irresistible that, where the term of twelve months' service expires by lapse of time, likewise must claim of loss be made within six months thereafter.

"Had all the bonds for the successive years been executed at one and the same time, contemplating and providing for a term of service extending over a period of three or four years, there would be per-

suasive plausibility in the contention of the learned counsel for the insured that the term 'expiration,' as employed in the contract, might be construed to refer to any time during the four years' term when the employee retired from such service. But the first contract was a separate and independent contract, — the only one during the twelve months in existence and in force, — and its provisions in the particular under consideration must be construed in respect of the twelve months' term contracted for by the insurer. The paragraph last above referred to concludes with these words: 'And upon the making of any such claim, on account of any employee, this bond shall wholly cease and determine, as regards any liability for any act or omission of such employee committed subsequent to the making of such claim.'

"This presupposes that a claim of loss might be presented during the running of the year of the term of employment, as there could be no continuance in service, in contemplation of the contract, after the end of the year, without a renewal contract. On the expiration of the term under the first bond, November 1, 1889, the insurer executed to the insured a like bond, assuring it against loss for the year ending November 1, 1890. This bond contains in legal effect the same recitals and conditions as its predecessor, except in the particulars now to be noted. Within it occurs this provision: 'That the company, upon the execution of a stipulated amount of risk or insurance, under the terms of this bond, in behalf of any employee, shall not thereafter be responsible to any employer under any previous insurance of said employee; it being mutually understood that it is the intention of this provision that but one (the last) insurance of the employee shall be in force at one time, unless otherwise provided.'

"Then follows this clause: 'The schedule hereto annexed is hereby declared to be a part of this bond.'

"This schedule referred to contains the following recitations: 'Whereas the schedule bond issued November 1, 1888, by the American Surety Company of New York, in favor of the Lombard Investment Company of Kansas City, Missouri, on certain employees therein mentioned, and others subsequently bonded and guaranteed subject to its provisions, expires November 1, 1889; and whereas said bond allows six months from said date of expiration in which to make claims for losses thereunder, the provisions contained in lines 91 to 95 of the bond hereto attached are hereby modified so as to recognize the right of the employer to make claim within six months from the expiration of the bond first mentioned, for any loss occurring thereunder; but with the understanding that the

aggregate liability of the said American Surety Company for the acts of any employee under both the bonds herein mentioned shall not during said period exceed the amount of the last guaranty or bond, upon the employee for whose acts a claim may be made.'

"This is an express declaration and claim on the part of the insurer as to its understanding of the effect of the provisions of the first bond in respect of the time within which any claim thereunder for loss should be made, to wit, within 'six months from said date of expiration,' which was November 1, 1889, unless, as we have shown, the period of expiration was earlier brought about by reason of the death, dismissal, or retirement from service of the employee. Therefore, in order to preserve to the insurer the benefit of the provision respecting the six months' time accorded in the first bond, this saving clause was added, qualifying the effect of the words contained within the lines from 91 to 95 in the preceding part of the last-named bond.

"When the plaintiff accepted this second bond, with its expressed provision of the limitation intended by the first bond, it thereby recognized and adopted such construction. Aside from the recognized rule that in construing a contract, weight will be given to the common understanding of the parties as to its effect, evidenced by their acts and admissions, when the plaintiff accepted from the defendant the second bond containing the explicit statement that only six months was allowed from the expiration of the first bond, to wit, November 1, 1889, with the further stipulation that the liability of the assurer for any loss occurring under either or both bonds should in no event exceed the sum guaranteed under the bond, which was $20,000, it created an estoppel against any claim based on a longer period of limitation, or for the liability of $40,000, the aggregate of the two bonds. When the second bond was presented, the plaintiff had the right to refuse to accept it, with the recitation contained in the schedule, and to demand a modification thereof. Failing to do so, by accepting the bond he left the assurer during the whole term of its duration relying upon the fact that the plaintiff understood the provision as to the time within which any claim for loss could be presented under the first bond, as stated in said schedule, as also that the extent of defendant's liability under both bonds did not exceed $20,000. Under such circumstances, the just rule of law applies, that he who remains silent when he should speak, shall not be heard to speak when he should be silent. No person will be allowed to adopt that part of a contract which is favorable, and reject the rest, to the injury of him from whom he derives the benefit. As no claim was made under the first bond of any loss for more than three years

after its expiration, the court, on the agreed statement of facts, declares the law to be that the plaintiff is not entitled to recover under the first count of the petition. While there is some variation in phraseology in the third bond, it in no essential manner differs from the legal effect of the second bond; and as the last two bonds, covering the terms, respectively, from November 1, 1889, to November 1, 1890, and from November 1, 1890, to November 1, 1891, are in their substantive effect the same, and no claim of loss under either was made prior to August, 1892, the same result must follow, that under the agreed statement of facts, the court declares the law to be that the insured is not entitled to recover under either the second or third counts of the petition; and the issues are found for the insurer." [1]

Where a fidelity bond stipulated that the insurer shall be liable for defaults of the "risk" occurring during the continuance of the bond or a renewal thereof and discovered during such continuance or within six months thereafter or within six months from the death or dismissal or retirement of such "risk," the insurer will be held liable for any misappropriations occurring during the continuance of the bond, although not discovered until more than six months after the default occurred, but within six months from the "risk's" dismissal, which occurred at once on the discovery being made.[2]

A conclusion in line with the foregoing was arrived at by the United States Supreme Court in American Surety Company *v.* Pauly.[3] Here a fidelity insurance policy had been issued containing a provision reading as follows:

"Notice of loss shall be in writing, addressed to the company as soon as practicable after the discovery of any loss for which the company is responsible, and within six months after the expiration or cancellation of this bond, as aforesaid."

In this case the bond expired by its limitation at the end of one year, and also by the death, dismissal or retirement of the

[1] See also Guar. Co. of N. A. *v.* Mech. Sav. Bank & Tr. Co., 183 U. S. 402; see also same case in lower court, 80 Fed. 766; 26 C. C. A. 394.

[2] Hawley *v.* U. S. Fid. & Guar. Co., 100 N. Y. App. Div. 12 Aff'd in 184 N. Y. 549.

[3] 170 U. S. 133; 18 Sup. Ct. Rep. 558; 42 Sup. Ct. Law Ed. 982.

employee from the service of the employer, and within six months thereafter the claim of loss was required to be made. The court, in its opinion, spoke as follows:

"We have seen that by the terms of the bond in suit the company agreed to make good and reimburse a loss to the bank, caused by any act of fraud or dishonesty on the part of O'Brien, in connection not only with his duties as cashier, but in connection with the duties to which in the employer's service he may be subsequently appointed, and occurring during the continuance of this bond, and discovered during such continuance, or within six months thereafter, and within six months from the death, or dismissal, or retirement of the employee from the service of the employer.

"The frauds to which the verdict of the jury referred occurred in October, 1891, during the continuance of the bond. The bank suspended November 12, 1891. The company insists that within the meaning of the bond, O'Brien's 'retirement' occurred when the bank ceased to do business and closed its doors, and the bank examiner entered upon an investigation of its affairs; consequently, it was argued, the discovery of the fraud was not within six months from the 'retirement of the employee from the service of the employer.'

"Undoubtedly, the company did not agree to be liable for any fraudulent or dishonest act of the cashier not discovered until after six months from retirement from the service of the bank. But is it true, that within the meaning of the bond, O'Brien retired from the service of the bank when it suspended business on November 12, 1891? We think not. The bank was in existence under its articles of association while the examiner, under the order of the comptroller of the currency, was engaged in the investigation of its affairs. Such investigation did not of itself have the effect to discharge O'Brien from its service. It is true that when the bank suspended business, and the investigation of the examiner commenced, O'Brien ceased to perform the ordinary duties of a cashier. But within the meaning of the bond, O'Brien did not retire from, but remained in, the service of the employer during at least the investigation of the bank's affairs and the custody of its assets by the national bank examiner, which lasted until the appointment of a receiver and his qualification on the twenty-ninth day of December, 1891. Certainly, the six months 'from the death or dismissal or retirement of the employee from the service of the employer,' within which his fraud or dishonesty must have been discovered in order to hold the company liable, did not commence to run prior to date last named. The bond prescribed at

least three limitations of time: first, the company was entitled to written notice of any act of fraud or dishonesty on the part of the employee, which might involve loss to it, as soon as practicable after the occurrence of such act should come to the knowledge of the employer; second, it was to be liable only for an act of fraud or dishonesty occurring and discovered during the continuance of the bond, and within six months thereafter; third, it was not liable, in any event, for any act of fraud or dishonesty, even if committed during the continuance of the bond, unless it was discovered within six months from the death, dismissal, or retirement of the employee from the service of the employer. Of course, O'Brien's death would have terminated his employment as cashier. But he was never dismissed, for his dismissal could only have occurred by the act of the bank or of some one who represented it before or after it suspended business. His 'retirement,' which would arise from his voluntary act, occurred either when he took service under the receiver, or when he voluntarily left that service on the second day of March, 1892. Whether within the meaning of the bond O'Brien was in the 'service of the employer' while he was in the service of the receiver, we need not say. It is sufficient for this case to hold that he was in the service of the employer at least up to the time of the receiver's appointment and qualification, which occurred within six months prior to the discovery of his fraud and dishonesty, and the giving of notice thereof. We, therefore, hold that the acts of fraud or dishonesty were discovered during the continuance of the bond, and within six months after the retirement of the employee from the service of the employer."

A conclusion, differing somewhat from that reached by the court in the foregoing case, was arrived at by the federal court of appeals in Florida Central and Peninsular Railroad *v.* American Surety Company.[1] In passing on this same question the court there said:

"The remaining question of the proper construction of the contract relates to that portion of Thompson's defalcations which were discovered three or four months after March 15, 1896, and before Thompson left the service of the railroad company. The contract indemnifies the employer against loss by dishonesty or culpable negligence of the named employee, which loss shall be discovered during the continuance of his insurance and within six months after the death, dismissal, or retirement of the employee causing such loss.

[1] 99 Fed. 674; 41 C. C. A. 45.

The loss must be discovered during the year for which indemnity was given if the employee is still in the position for which his fidelity has been guaranteed; but if the employee died, was dismissed, or retired during the year, it must be discovered within six months after such retirement. Cases may easily be imagined of hardship under the stringent terms of this policy, and what would be the result in the case of loss happening during the last days of the life of the contract when discovery was impossible during its life is a question which does not arise here. The loss which was the subject of the fourth item (of Thompson's defalcations) commenced before January 1, 1896, when there was a balance against Thompson of $1,177.56, and continued until August 1, 1896, when it had been reduced to $1,047.64. He had apparently drawn the railroad checks for the payment of his previous bills from time to time during the period of his treasuryship, but the company's system of audit was very lax and the state of the cash account was unknown and not examined, — a condition of affairs which was intended to be guarded against by the narrow terms of the contract of indemnity. Inasmuch as the annual renewal of the contract of indemnity ceased on March 15, 1896, when Thompson was acting as treasurer, the liability ceased as to all losses which had not been discovered. If Thompson had ceased to be treasurer before March 15, 1896, the facts of the case would have corresponded with those in Guarantee Company of North America *v.* Mechanics Savings Bank and Trust Company,[1] in which fifteen days before the employee's yearly insurance ended he was retired by promotion from the position which he held and the loss was discovered about three months after his retiracy, in which case the court held that the six months commenced to run at the time of the retirement and continued without reference to the termination of the annual period, — a conclusion which is justified by the terms of the contract."

In a Canadian case the insurer's policy provided that it should make good to the insured such pecuniary loss as he might sustain by reason of the dishonesty of the "risk," committed and discovered during the life of the policy and within the three months from the death, dismissal or retirement of the "risk." It was held that the insurer was not liable thereunder for the defalcation of such "risk," discovered four months after the policy lapsed.[2]

[1] 80 Fed. Rep. 766; 26 C. C. A. 394.

[2] Com. Mut. Bldg. Soc. *v.* London Guar. & Acc. Co., 7 Montreal L. R. Q. B. 307.

Where the policy provides that the right to make a claim thereunder in behalf of the insured and against the insurer shall cease at the end of six months from the default or dismissal of the "risk," it is given on good consideration and is reasonable, and will be upheld both in law and in equity.[1]

When a fidelity bond is given for the integrity of a "risk" in consideration of the latter's appointment to an office by the insured, the liability of the insurer will not, unless so expressly stipulated in the policy, be determined by his death.[2]

§ 109. (D) **Condition limiting the Right of the Insured to make and file Claims under the Policy to a certain Designated Period after the Insolvency of, or Discontinuance of Business by, the Insured.** — It is usually provided that in the event of the insolvency or discontinuance of business on the part of the insured, the right to make a claim under the policy shall cease at the end of ninety days after either of such events, whichever shall first happen. The theory upon which it would undoubtedly be contended that the foregoing condition should be sustained as valid would be this: That the contract of fidelity insurance being a personal one, the insolvency of the insured, throwing the latter into the hands of an assignee or receiver, changes the personality of the insured. Besides this, the discontinuance of that line of business on the part of the insured, which is designated in the proposal for the policy, amounts in a certain sense to an absence of that particular or identical insurable interest possessed by the insured before the business passed into the hands of an assignee or a receiver, who represents creditors as well as the insured. Even in the absence of the foregoing condition, there could be no liability on the part of the insurer after such insolvency or discontinuance of business on the part of the insured had occurred.

The word "insolvency," in this connection, probably has reference to the time when the insured is declared insolvent

[1] Sayville Admr., *et al.*, 101 Va. 217; 43 S. E. 351.

[2] *In re* Grace, 1 L. R. Ch. Div. 1902, p. 733; see also Gordon *v.* Calvert, 2 Sim. 253; Lloyd's Harper, L. R. 16 Ch. Div. 290.

by some court of competent jurisdiction, or makes a voluntary assignment for the benefit of creditors.[1]

The term "discontinuance" has relation to the act of the insured, either voluntary or as an act consequential thereof.[2]

§ 110. (E) **Condition excluding from Liability all Claims for Money used by the "Risk" within the Period of Liability to repay or refund Moneys taken by the Latter from the Insured prior to the Commencement of the Insurer's Liability under the Policy or prior to a Designated Period next before the Time of giving Notice to the Insurer by the Insured of a Claim thereunder.** — To give rise to the above condition referred to, framers of guaranty insurance policies usually insert some such clause as the following:

> "That the insurer shall not be liable thereunder for or on account of moneys or property used or applied by the 'risk' within a period of twelve months before the time of giving notice to the insurer by the insured of a claim thereunder or for property taken from the insured by the 'risk' prior to such twelve months or prior to the date of the commencement of the policy in each case."

The general purpose of the foregoing condition is to prevent the insured taking advantage of any processes of dishonesty or forced bookkeeping employed by the "risk" to conceal his fraudulent and dishonest acts, and which, if treated as conclusive between the insurer and the insured, would have the effect of making the former liable for acts which occurred at a period not covered by the policy under which claim of loss is made by the insured. The leading case on this subject is that of the Supreme Council of Catholic Knights of America *v.* Fidelity and Casualty Company of New York.[3] In this case the insured placed a claim of loss with the insurer, claiming that one O'Brien, who was named as the "risk" in the policy, had embezzled money belonging to the insured. In support of this claim evidence was offered showing that during the "risk's" preceding term he had failed to pay certain drafts

[1] See *post*, § 159.

[2] Am. Indem. Co. *v.* Cassard, 83 Md. 272; 34 Atl. 703.

[3] 63 Fed. 48; 11 C. C. A. 96.

drawn during that period. These drafts he carried forward into his new term (covered by the bond in suit) and then paid them during this last term out of current receipts. The contention of the insured at the trial was that these drafts should have been paid out of the balance which should have been in the "risk's" hands at the end of the preceding term; that, if the funds which ought to have been in his hands for that purpose had been theretofore embezzled, he could not make good a former defalcation out of the funds of his new term, and that the payment of these obligations out of the funds which came to his hands during the new term was in itself such a misappropriation as fixed the liability of his surety for the new term. The court, in its opinion in this case, said:

"The business of the insured was not conducted in such a way that the obligation of the Order was discharged when an assessment was made sufficient to meet it. Assessments were made from time to time of amounts deemed sufficient to meet death loss accruing, pay expenses, and provide a sinking fund. The liability of the Order was not *extinguished* by the misappropriation of the fund thus assessed to meet accruing and fixed obligations. The funds coming to O'Brien's hands were not so earmarked as to amount to an appropriation of a particular dollar to the payment of a particular claim. If assessments were made sufficient to meet certain death claims and the fund came to the hands of O'Brien, these claims were not thereby extinguished. If O'Brien embezzled the funds so appropriated, the association was not thereby relieved of liability. The claims were obligations of the Order and continued to be obligations until paid. When these obligations were paid out of subsequent funds of the Order, it was only a case where the debt of the association was paid out of its own funds. No species of reasoning can make the application of plaintiff's money to the payment of its own obligations either embezzlement or larceny. The fund which had been provided for the payment of these claims had already been embezzled. The loss thus sustained should be borne by the bond in force when the default occurred. For that loss the new bond is not responsible."

With the ruling in the foregoing case in mind, attention is called to the decision of the United States court of appeals

(third circuit) in Fidelity and Casualty Company of New York *v.* Consolidated National Bank.[1] Here a guaranty policy was issued on September 30, 1889, to the Consolidated National Bank on one Baker as paying teller thereof. The policy was regularly renewed and extended to September 30, 1894. On January 10, 1894, it was discovered that Baker was guilty of fraud and dishonesty. Under the terms of the policy the insurer was bound to make good to the insured such pecuniary loss as the latter had sustained by reason of Baker's defaults, committed within twelve months next preceding that date. During that period he had embezzled $5000, for which the insurer admitted liability. During this period the "risk" had falsified the books and balance sheets of the bank, and at the trial the jury was instructed, that if the "risk's" misconduct prevented the discovery of previous embezzlements, and thus prevented the recovery on this account from the insurer of money which it otherwise would have recovered, the insured was entitled to recover the loss sustained during a period of twelve months preceding the time when such embezzlements would have been discovered but for this concealment. Commenting on the foregoing instruction, the court spoke as follows:

"Waiving any question as to whether such prevention of recovery constituted such a pecuniary loss as should be taken to be covered by the covenant for reimbursement, if that covenant were to be read and separately considered, we have, upon careful examination of the writing as a whole, been fully convinced that the covenantor's engagement cannot be so construed. Throughout the document, the frauds as to which indemnification is undertaken are so mentioned in connection with the subject of their discovery as to repel the assumption that steps taken for the avoidance of detection were themselves to be regarded as independent, fraudulent acts, the commission of which would have the effect of extending the time allowed for discovery of the primary and principal defaults. One of the express conditions upon which the policy was issued, when understood as we think the parties must have understood it, absolutely forbids that assumption. We refer to the provision, that any claim made under the policy should embrace and cover only acts and defaults com-

[1] 71 Fed. 116; 17 C. C. A. 641.

mitted within twelve months next before the discovery of the act or default upon which such claim is based. That the officer of the bank which accepted this policy, as well as those of the corporation which issued it, well understand the nature of the hazard to which it relates, may be safely assumed. They knew that the commission of fraud is generally supplemented by precautions for its concealment, and that the teller of a bank, who embezzles the money, is very likely to tamper with its accounts to prevent their disclosure of his wrong-doing. Can it be then said that they intended that, if timely discovery should be prevented by such means, the prevention so occasioned would itself constitute a distinct basis of claim? To so interpret the condition would be to render it unavailing in the event of that being done, which, as we have said, must have been foreseen, and which, there being no expression to the contrary, must have been regarded as, at least, one of the contingencies which might cause the condition to become operative. The manifest intent was to create a bar, and to the provision inserted for that purpose there cannot be annexed an exception or qualification not warranted by its terms, and the implication of which the circumstances of the case forbid. The object was to preclude liability for a number of defaults, extending over a longer period than one year, and yet the present claim is that in addition to $5000, the amount of the embezzlements within such period, the indemnifying company is chargeable with the amount of other embezzlements which had been committed during a prior term. We cannot sustain this demand, because to do so, we think, would involve a misconstruction of the condition and the defeat of its purpose. The bank's position rests upon the assumption that it would have recovered its earlier losses, by action upon this policy, but for the fraudulent postponement of their discovery. Let this be conceded, still it is obvious that reasonable discovery of the preceding dishonest acts would have rendered the perpetration of the succeeding ones impossible, and that hence the entire liability now asserted is one which could not possibly have occurred, if discovery of the earlier embezzlements had been made within the prescribed time; and it is not possible to hold, in the face of a condition limiting liability by a requirement of discovery, that by reason of non-discovery, the liability so limited was extended or enlarged."[1]

In Banque Nationale *v.* Lesperance[2] it was held that where the evidence showed that a teller of a bank indorsed on a par-

[1] See also F. C. & P. R. R. *v.* Am. Sur. Co., 99 Fed. 674; 41 C. C. A. 45.

[2] 4 Leg. N. Quebec, 147.

cel of bank notes the amount which it was supposed to contain and it was subsequently discovered that the parcel was $9300 short, and it was also ascertained that a deficiency of the same amount existed in the teller's account, and had been during several years skilfully covered up and concealed from the authorities of the bank, who made the usual inspection, the insurance company which had issued a policy guaranteeing the fidelity of the teller was liable for the deficiency, but only for so much thereof as accrued after the policy was issued. In a late Tennessee case the defendant, a surety company, executed a bond to plaintiff bank, by which it undertook for the term of one year to indemnify plaintiff against loss sustained by the dishonesty of an employee. Action was brought thereon to recover for loss alleged to have occurred during the term through the action of a bookkeeper in falsifying the amount of deposits so as to increase his credit to a large amount. Such false entries and overdrafts continued during a period of four years, and defendant's bond covered only about three months of the last part of the bookkeeper's employment, there having been bonds with different sureties covering a portion at least of the previous time. The depositor's account was a running account subject to check, and continued during all the time, and no application of funds to any particular item of debt was made by either party, only by implication, there having at one time been overdrafts as shown by the books. The false entries and overdrafts continued for a part of the time after defendant's bond went into effect, but subsequent deposits made prior to the time the bookkeeper's employment terminated, exceeded checks paid during the same time in an amount greater than such overdrafts. It was held that the ordinary rule in such cases between debtor and creditor that payments should be apportioned to the last item of indebtedness, could not apply as against the "surety company" whose bond covered a definite portion of the time during which the account was running; but that as between plaintiff and

defendant, all deposits made during the currency of the bond would be applied by the court during the same time; it appearing that they exceeded the sums drawn out, there was no loss to the bank during the term for which the defendant was liable.[1]

When there are different bonds given by a bank official, covering different periods of time with different sureties, a payment made by the common principal is not always to be applied by the court to the last obligation. Regard must be had to the responsibility of the different sureties as limited by the period for which they respectively contracted as well as to the injustice that would ensue if collections received under one application are applied to the discharge of liability under preceding or succeeding term with different sureties.[2]

§ 111. (V) **Conditions excepting, either expressly or impliedly, Certain Perils for which the Insurer shall be Liable under the Policy.**—The perils here referred to are those which, either by the express language of the policy or by implication of law, are excluded from the operation of the policy as a basis for any claim of loss on the part of the insured against the insurer. These excepted perils will be divided for purpose of classification hereunder into two classes, to wit: (A) Express exceptions, and (B) Implied exceptions.

§ 112. (A) **Express Exceptions.**—The perils here referred to are those which by the express language of the policy are excluded absolutely from consideration as the basis for any claim of loss on the part of the insured against the insurer. The principal "express exceptions" will be here set forth at length. They are as follows:

(1) The insurer shall in no way be held liable by virtue of the policy to make good any loss that may accrue to the insured by reason of any act or thing done or left undone by the said

[1] First Nat. Bank of Nashville *v.* Nat. Sur. Co., 130 Fed. 40; C. C. A. 6th Cir.

[2] *Idem.;* see Model Mill Co. *v.* Fid. & Dep. Co., 1 Tenn. Ch. Ap. Rep. 365; Perpetual Bldg. & Loan Ass. *v.* U. S. Fid. & Guar. Co., 118 Ia. 729; 92 N. W. 686.

"risk" in obedience to or in pursuance to any direction, instruction or authorization conveyed to and received by him from said insured.[1]

The non-liability of the insurer under the foregoing condition is based upon the sound proposition that where the act complained of on the part of the "risk" is done pursuant to instructions from the insured, that then and in such case the act becomes, under well recognized principles of agency, the act of the insured and not of the "risk." For wrongful acts on the part of the insured the latter can of course have no recovery against the insurer. This for the reason that the policy only covers acts of the "risk" which are in violation of the latter's duty to the insured, and where the act complained of is either directed by or acquiesced in by the insured, there can of course be no violation of duty under such circumstances on the part of the "risk."[2]

(2) The insurer shall not be held liable by virtue of the policy for any mere errors of judgment or injudicious exercise of discretion on the part of the "risk" in and about all or any matters wherein he shall have been vested with discretion either by instructions or rules and regulations of the insured.

The foregoing condition is one concerning which it is difficult to lay down any general rule applicable thereto. In fact, it serves to remove a large class of acts from the domain of liability under the policy which might otherwise be claimed to be fraudulent by the insured. In other words, it imposes a clear mark of distinction between mistakes of judgment and intentional fraudulent acts. In cases of doubt as to the character of an act, it would then become a question of fact, to be determined by a jury, under proper instructions from the court.

(3) The insurer shall not be held liable, by virtue of the policy, to make good any loss by fire, robbery, theft or other-

[1] See Hay *v.* Guar. Lia. Ind. Co., 181 Pa. St. 220; 37 Atl. 402.

[2] Northern Assur. Co. of Eng. *v.* Borgelt, *et al.*, 67 Neb. 282; 93 N. W. 226.

wise, that said insured may sustain, except when occasioned by the felonious or fraudulent acts of the "risk." [1]

The foregoing exception needs but little comment, as its meaning is clear and unambiguous. Fidelity insurance policies cover personal acts of the "risk" and cannot by a forced construction be extended as to apply to losses occasioned by either the act of God or by the act of third parties acting with fraudulent or dishonest intent and without the connivance of the "risk." The only practical difficulty to be encountered in this connection is to determine questions of fact under the evidence submitted, where the "risk" attempts to explain the loss or injury to property entrusted to him, by claiming that such loss was occasioned by robbery, theft or accidental loss over which he had no control.

(4) The insurer shall not be held liable for any losses that the insured may sustain except through the direct personal act of the "risk" or by his connivance.[2]

The foregoing condition simply serves to emphasize the prevailing rule which governs fidelity insurance policies, to wit: that the insurer is only liable for the direct fraudulent or dishonest personal acts of the "risk" or for such fraudulent or dishonest acts resulting in loss to the insured, which were brought about or occasioned by the indirect act or connivance of the "risk."

Where in a suit upon a bond executed to a loan company. guaranteeing the honesty of an employee, it appeared that it was stipulated in the application for such bond that the duties of such employee would be to receive and deposit all moneys received by the company, to indorse checks for deposit only, and that he was not authorized to sign checks or to accept drafts, or to pay out on account, and was without authority to withdraw money, and the obligation of the bond was to make good any loss occasioned by the fraud or dishonesty of

[1] Walker *v.* British Guar. Ass., L. R. 18 Q. B. 277.

[2] See Clifton Mfg. Co. *v.* U. S. Fid. & Guar. Co., 38 S. E. 790; Mut. Bldg. & Home Ass. *v.* Fid. & Dep. Co., 50 La. 291; 23 Sou. 405.

such employee in connection with his duties as specified, and the insurer was not to be liable for other than *the personal acts of such employee within the direct scope of his specified duties*, the insurer cannot be held for the dishonesty of such employee, in inducing the loan company to accept a loan to a fictitious person on fictitious security, and procuring the money from a bank where the money of the company was on deposit, on a check issued by the insured in the name of such fictitious borrower, by forging his name upon the check.[1]

(5) The insurer shall not be liable under the policy for the value of property entrusted by the insured to the "risk" for purpose of sale, and sold by the latter on credit, or for collections thereof outstanding, even though such sale be made in express violation of the rules and directions of the insured.[2]

The foregoing condition points out the radical distinction that exists between losses resulting to the insured by the extension of credit by the "risk" to third parties contrary to instructions, and such losses as arise through acts of the "risk" which are intentionally fraudulent and dishonest. In the former case the insurer cannot be held liable under the policy, while in the latter case, other things being equal, he may be held.

(6) The insurer shall not be liable by virtue of the policy for any loss arising from wrongful independent acts of subordinates of the "risk."[3]

This condition is a most important one, and serves to relieve the insurer from liability under a policy of fidelity insurance for many alleged wrongful and fraudulent acts of the "risk" which were, in fact, the acts of third parties. This condition is, of course, based upon the assumption that the wrongful, independent acts of subordinates of the "risk," here referred to, shall not have been committed under the direction or with the connivance of the "risk" himself.

The president of a life insurance company is not responsible

[1] Livingston, *et al.* v. Fid. & Dep. Co., 76 Ohio 253; 81 N. E. 330.

[2] See Dougherty v. London Guar. & Acc. Co., 6 Vic. L. R. 376.

[3] London Assur. Corp. v. Bold, 6 Ad. & Ed. 523.

on his official bond, for the act of a bonded cashier, in placing funds to the credit of the "risk's" (the president's) account on the books of the corporation when so placed without his knowledge.[1]

In all cases where it is claimed that the insurer is relieved from liability by reason of the loss for which indemnity is claimed by the insured, coming within any of the excepted perils designated in the policy, the burden of proving that such losses are within the said exception lies with the insurer.[2]

It must not be inferred that the exceptions to liability here referred to cover every liability or claim which might accrue in favor of the insured against the "risk" during the period of time named in the policy, for such is by no means the case. The liability of the insurer to the insured is fixed and determined by the terms of the policy; that of the "risk" to the insured is fixed solely by the contract of employment had between them. It is thus apparent that the test of liability in each case is the provisions of separate and distinct contracts. While the liability of the insurer to the insured (in order to be valid and enforceable) must necessarily be based upon a corresponding liability identical in nature and amount with that of the "risk" to the insured, the same is not always true in the reverse sense.[3]

§ 113. (B) **Implied Exceptions.** — The law implies, irrespective of express provision therefor made in the policy, certain conditions limiting the liability of the insurer to the insured under the terms thereof. These implied exceptions to liability may be enumerated as follows:

(A) It is one of the implied conditions in contracts of fidelity insurance, that the insured shall not require nor suffer the "risk" to do any illegal acts in the performance of the

[1] Sherman *v.* Harbin, 125 Ia. 175; 100 N. W. 629.

[2] Dennis *v.* U. M. L. Ins. Co., 84 Cal. 370; 24 Pac. 120.

[3] See Monongahela Coal Co. *v.* Fid. & Dep. Co. of Md., 94 Fed. 732; 36 C. C. A. 414; Fid. & Dep. Co. *v.* Schelper, *et al.*, Tex. ; 83 S. W. 871.

duties of the position in connection with which the policy of fidelity insurance was issued.[1]

(B) From the very nature of a policy of fidelity insurance, which is at all times a contract of indemnity, it follows as one of the implied conditions of the policy that the insured shall continue throughout the life of the policy to have an insurable interest therein. The recognition of such an implied condition is sometimes termed the "doctrine of continuity of interest."[2]

(C) It is customary to designate in the policy the place where the "risk" is to be employed during the period of liability covered by the policy, indemnifying the insured against loss through acts of such "risk" while in said employment. While in general policies do not contain any express conditions to the effect that the "risk" shall remain in such place during the period of liability covered by the policy, nevertheless such a condition is implied by law where such place is specifically designated in the application, and this implied condition must be observed by the insured if he desires at any subsequent period to enforce the insurer's liability under the policy.[3]

Thus in Fidelity and Casualty Company *v.* Brown [4] it was held in an action on the fidelity bond of an agent of an insurance company, to recover the amount of certain collected and unremitted premiums, that it was error to sustain a motion to strike from the petition certain premiums charged in the account because collected outside the agent's territory where the language describing his territory is ambiguous and sup-

[1] McKenna-Frazer Co. *v.* Cit. Tr. & Sur. Co., 76 Fed. 420; German-American Title & Tr. Co. *v.* Citizens Tr. & Sur. Co., 46 Atl. 682; B. & A. R. R. *v.* Mer. Tr. & Dep. Co., 34 Atl. 778; Lyman *v.* Schermerhorn, *et al.*, 53 App. Div. N. Y. 32; 167 N. Y. 113; Lyman *v.* Kane, *et al.*, 57 App. Div. N. Y. 549.

[2] See Mut. Bldg. & Home Ass. *v.* Fid. & Dep. Co., 23 Sou. 405; 50 La. 291; Cohen *v.* Am. Sur. Co., 123 N. Y. App. Div. 519; see *post*, § 179.

[3] See Fid. & Cas. Co. of N. Y. *v.* Lawler, *et al.*, 64 Minn. 144; 66 N. W. 143; U. S. to the use of Anniston Pipe & Foundry Co. *v.* Nat. Sur. Co., 92 Fed. 549; 34 C. C. A. 526; U. S. to the use of Heise, Bruns & Co. *v.* Am. Bond. & Tr. Co., 89 Fed. 921–25; 32 C. C. A. 420.

[4] 69 Kan. 550; 77 Pac. 111.

portable of different interpretations. Under such circumstances, whether the premiums were collected within the agent's territory becomes a question of fact.

(D) One of the implied conditions of all policies of fidelity insurance is that the "risk" shall continue to occupy the position in the employ of the insured designated in the proposal or application for the policy. Unless the policy expressly provides for changes in such employment, as, for example, expressly authorizing employment in more than one position, or changes from one position to another, there can be no recovery had by the insured from the insurer on account of defaults of the "risk" occurring while performing duties of a position materially different from that designated in such proposal or application. The reason which induces the courts to imply such a condition as the foregoing, is that fidelity insurance companies write policies for certain designated premiums, which vary in amount according to the nature and extent of the risk incurred. If, for example, the insured asks the insurer to write a policy on a person employed as a bookkeeper in a bank, the insurer might be willing to do this at a very low premium, owing to the small chance of its ever being required to make good any losses occasioned by such person's dishonesty while occupying the position of bookkeeper for the insured. However, if it lay within the power of the insured to change the employment at will of such person, and immediately after issuing the policy he should appoint him cashier instead of bookkeeper, it would amount to little less than a fraud upon the insurer to hold the latter liable for his acts and increased responsibilities not in contemplation of both parties at the time the policy was issued.[1]

The question here under discussion was passed upon by the Kentucky Court of Appeals in Champion Ice and Cold Storage Company *v.* American Bonding and Trust Company.[2] Here a

[1] Wembley Urban Dis. Coun. *v.* Poor Law, etc. Guar. Ass., 17 T. L. R. 516; see also G. S. & L. Co. *v.* Emp. Lia. Assur. Corp., 13 Manitoba Rep. 531.

[2] 115 Ky. Ct. of Ap. 863; 75 S. W. 197.

bond was issued insuring the employer against fraudulent acts of the "risk" named in the bond amounting to larceny or embezzlement in the latter's position as bookkeeper, *and in any other position to which he might be called.* In holding the "surety company" liable on the bond issued by it for defaults committed by the "risk" in the employment of the insured in a position other than that of bookkeeper, the court based its opinion solely on the ground that the bond specifically authorized the insured to charge the "risk's" employment.

"There can be no question," observed the court, "but that the covenants of the bond covered such a loss as was sustained by the appellant. Its one purpose was to insure against loss that might result to appellant from the fraud or dishonesty of Weitkamp (the 'risk') amounting to larceny or embezzlement, whether the loss was that of money, securities or other personal property belonging to the appellant or for which it might be made responsible; or dishonesty which Weitkamp might have committed in the performance of his duties as bookkeeper, but also to such as he may have committed, in any other position in appellant's employment to which he may have been appointed or called upon to fill. It is not material, therefore, whether fraudulent or dishonest acts of Weitkamp which caused loss to the appellant were committed by the making of false entries in its books, by the raising of its checks or by abstracting moneys from its money drawer, nor is it material whether he was at the time acting as bookkeeper or in some other capacity in appellant's service. Under either or any of this evidence, appellee under the terms of the bond would be and is liable for the loss which he occasioned."

(E) Another implied condition of fidelity insurance policies is that there shall be no change in the composition of the insured or in the personality of the "risk" during the life of the policy. Fidelity insurance is a personal contract, and there should be no alteration permitted either as to parties insured, or as to the "risk" without the consent of the insurer.[1] To just what extent the foregoing implied condition will be sustained by the courts, in the case of change in the composition of the insured, it is at present impossible to say. A practical

[1] See *post*, § 177.

opportunity to enforce the condition is likely to occur when there is an attempt made by the insured to assign the policy prior to the occurrence of loss or where partners are admitted or changed or where a copartnership is merged into a corporation. One of the unquestioned implied conditions of every policy of fidelity insurance is that it is not assignable without the consent of the insurer.[1]

A recent case where the question was briefly considered in connection with a policy of commercial insurance is that of National Surety Company *v.* T. B. Townsend Brick and Construction Company.[2] Here, after the policy was issued, the insured formed a copartnership with a third party. It was argued that by reason thereof there was no privity of contract between the new parties and the insurer, and that there was a concealment of parties, and that the policy was therefore void. This proposition was regarded very unfavorably by the court. This on the ground that such change in the composition of the insured did "not necessarily affect the contract between the 'risk' and the insured." In the appellate court it was said that there was no element of estoppel involved, for it could not be said that the insurer was in any way misled or defrauded at the time it issued the policy and in no way prejudiced by it afterward. No injustice resulted to it either by that fact or its concealment. The doctrine in the case just referred to is certainly opposed to the general rule above stated. By way of comment thereon, the following may be said. However, the courts may hereafter decide as to the effect of changes in the composition of the insured after a policy has been issued, it seems clear that where there has been a change made in the personality of the "risk" during the life of the policy by the insured, without the knowledge or con-

[1] See post, §117; Solv. Mut. Guar. Co. *v.* Freeman, 7 H. & N. 17; London Assur. Co. *v.* Bold, L. R. 6 Q. B. 514; Am. Cr. Ind. Ci. *v.* Wood, 73 Fed. 81; 19 C. C. A. 264; Strouse *v.* Am. Cr. Ind. Co., 91 Md. 244; 46 Atl. 328; 1063; Fohs *v.* Rain, 39 N. Y. Misc. 316; 113 N. Y. St. Rep. 872; 79 N. Y. Sup. 872.

[2] 74 Ill. App. 312; 176 Ill. 156; 52 N. E. 938.

sent of the insurer, the legal effect is necessarily to relieve the latter from any liability that might otherwise accrue after such change occurred. This for the cogent reason that the act which caused the loss would not, under such circumstances, be the act of the party whose personal acts alone constitute the basis of the insurer's liability under the policy.

A corporation is not dissolved by any adjudication that it is a bankrupt. The bankruptcy of the insured does not discharge the surety on its bond.[1]

A person having possession and absolute control of merchandise shipped to him to sell and collect the price is a commission merchant and not a broker.[2] When a contract between plaintiff and their agents provided that the latter should have the agency of certain goods as "brokers or commission merchants," a representation to a company issuing bonds insuring the fidelity of the agents that they were "brokers" is not a fraud, vitiating the bond.[3]

A bond given to a surety company recited that it was to secure the "company" against loss on a bond in which the company had become surety for A and B, and a copy of said bond, which showed that A alone was principal therein, but that the bond was executed by B as attorney in fact for A, was attached to the bond in suit. It was held that the mistake in the bond in suit, in reciting that the bond was given as security for both A and B, would not relieve the sureties from liability, as they could not have been misled thereby.[4]

(F) Another important implied condition which has been touched upon in other parts of this work, is that all claims sought to be enforced by the insured against

[1] Nat. Sur. Co. *v.* Medlock, 2 Ga. App. 665.

[2] T. M. Sinclair & Co. Ltd. *v.* Nat. Sur. Co., 132 Ia. 549; 107 N. W. 184.

[3] *Idem.*

[4] Stillwell, *et al. v.* Am. Sur. Co., 70 Ark. 512; 68 S. W. 1021; see also Fid. & Dep. Co. *v.* Courtney, 186 U. S. 242; 46 L. E. 1193.

the insurer under the policy must be such as would in themselves be legally enforceable in favor of the insured against the risk.[1]

So, too, the foregoing principle, if admitted, would prevent recovery, wherever the insured has given to the "risk" a valid release of any claim against him personally by reason of the claim afterwards asserted against the insurer. It is likewise true that where there has been a settlement of loss directly between the insured and the "risk" the former cannot exact indemnity from the insurer under the policy. It is only after the debtor or the "risk" as he is called in insurance law, has made a default that the liability under the policy accrues. If the "risk" has not made default, the insurer is not liable.[2] So again the indemnity which it is incumbent upon the insurer to make to the insured has been said to be full indemnity, within the scope and limitations of the policy, — nothing more and nothing less.[3]

In general there can be no recovery had by the insured against the insurer under a policy unless there is in existence at the same time a valid and enforceable claim against the "risk" for the same cause in favor of the insured.[4] The reason of this is obvious. Fidelity insurance is a contract of indemnity only, and further it is an indemnity against loss arising from acts of the "risk" in breach of his own contract obligations to the insured. Thus an unquestioned limitation on the insurer's liability is that the claim shall be a valid and enforceable one against the "risk" in favor of the insured. Were this not so, the valued right of subrogation would be worthless to the insurer, as he could not in any event recover

[1] See *ante*, § 30; State *ex rel.* *v.* Sur. Co., 73 Mo. App. 227; North St. Louis Bldg. & Loan Ass. *v.* Obert, *et al.*, 169 Mo. 507.

[2] Walker *v.* Br. Guar. Co.; L. R. 18 Q. B. 77.

[3] See Guar. Co. of N. A. *v.* Mech. Sav. Bank, 80 Fed. 776; 26 C. C. A. 146; Bank of Tarboro *v.* Fid. & Dep. Co., 35 S. E. 588; 126 N. C. 320; 38 S. E. 908; 128 N. C. 366.

[4] Am. Sur. Co. *v.* U. S. to the use of Barrett, 127 Ala. 349; 28 Sou. 664; but see School Comm'rs. *v.* Guar. Co., 31 Lower Canada Jour. 254; see also *ante*, § 30.

of the "risk" the amount he had paid to the insured on an invalid and unenforceable claim.[1]

The foregoing rule removes, of course, from the scope of the insurer's liability all cases where the loss is induced through the active connivance of, or collusion on the part of, the insured with the "risk."[2]

As it is a sound principle of law that the obligation of the insurer to the insured can never be greater than the liability of the "risk" to the insured,[3] so it may be said that the law implies from policies of guaranty insurance the condition, irrespective of express conditions in the policy to that effect, that the liability of the "risk" to the insured after a loss has occurred, for which the insurer is liable to the insured under the policy, shall not be changed in any material respect. This on the principle that the inchoate right of subrogation belonging to the insured under such circumstances is a valuable right, and that for this reason no material change in the status of the "risk" with respect to the latter's liability to the insured, as it existed at the time the loss occurred, will be permitted. This question was touched upon at considerable length in a case involving a contract of commercial insurance wherein a principle was established, that is perhaps applicable to contracts of fidelity insurance. Reference is made to the case of the United States to the use of Heise, Bruns and Company *v.* American Bonding and Trust Company.[4] In this case the insured had extended the time of payment of certain claims due from the "risk' to the insured, and for the payment of which it was sought to make the insurer liable. In an action brought by the insured against the insurer to enforce such lia-

[1] See Bank of Tarboro *v.* Fid. & Dep. Co., 35 S. E. 588; 126 N. C. 320; 38 N. E. 908; 128 N. E. 366.

[2] Pac. Ins. Co. *v.* Pac. Sur. Co., 93 Cal. 7; 28 Pac. 842; Monongahela Coal Co. *v.* Fid & Dep. Co., 94 Fed. 732; 36 C. C. A. 444; State *ex rel. v.* Sur. Co., 76 Mo. App. 227.

[3] Fid. & Dep. Co. *v.* Schelper, *et al.*, Tex. ; 83 S. W. 871; Blades *v.* Dewey, *et al.*, 136 N. C. 176; 48 S. E. 626; Wood Sewing Machine Co. *v.* Winchel, *et al.*, 107 Ind. 260; 7 N. E. 881.

[4] 89 Fed. 921–925; 32 C. C. A. 420.

bility under the policy, the insurer claimed that it had been released from liability under its policy through an extension of time by the insured to the "risk," whereby the insurer was deprived of the opportunity of compelling appropriation of certain payments made by the United States government to the insured on claims for materials. The court, in its opinion, said in reference to this condition:

> "The law of suretyship forbids that there shall be such dealings between the debtor and the creditor of which the surety is kept in ignorance as shall put the surety in a situation of peril. Looking to the opportunity for protecting himself which the surety has if the debt for the materials is due when the final payment is made by the government, it seems but reasonable, that if the material man designedly extends the time of payment beyond that time, he should be held to have released the surety and to have elected to look solely to the debtor." [1]

(G) Finally, it may be said to be an implied condition of every fidelity insurance policy that the loss to be an enforceable one, must have occurred during the life of the policy. In connection with the foregoing, it may also be asserted that the burden of proof rests with the insured to show that such loss occurred during the life of the policy sued on. The proposition here stated came up for consideration in the case of the Standard Oil Company *v.* Fidelity and Casualty Company of New York,[2] where it was claimed by the insured that all that it was necessary for it to do in order to establish liability against the insurer under the policy was to show that the "risk" collected more than he had accounted for. In passing upon the question, the count impliedly gave its sanction to the proposition that the burden of proof is on the insured to show that the loss occurred in its entirety during the life of the policy. This appears to be the correct rule.

[1] See generally La Canadienne *v.* London Guar., 9 Quebec Q. B. 183; City of Middletown *v.* Ætna Ind. Co., 97 N. Y. App. Div. 344; 90 N. Y. Sup. 16.

[2] 21 Ky. L. Rep. 399; 51 S. W. 571.

As bearing upon the question, attention is called to the case of Wapello State Savings Bank *v.* Colton, *et al.*[1] Here it was held that the board of trustees of a bank after an indefinite appointment of a person to the position of cashier may make a new appointment of the same person as cashier for a definite period, although there was no interruption in the service; and the sureties on his official bond under the original appointment are not liable for his defalcations occurring during the new term, in the absence of language in the bond itself giving it effect beyond such change in the term of appointment.

Defendant was elected by plaintiff's board of trustees cashier of plaintiff's bank to hold office "during the pleasure of the board," at a salary of $100 a month, and the required bond, with co-defendants as sureties thereon, was given by him. Subsequently and while he was still acting as cashier, the board, with reference to his continuance in that employment, voted that defendant be employed for the next year as cashier, and fixed his salary together with that of another clerk at a total sum of $1200 a year. It was held, that this last action of the board terminated the defendant's previous indefinite term of employment and that the sureties were not liable for defalcations occurring after the termination of such definite term. The court, in its opinion, spoke as follows:

"Appellant cites cases which seem to support the proposition that, after an appointment for an indefinite period, the mere reëlection for an indefinite term does not fix a new tenure so as to terminate liability under a bond given in connection with the original indefinite appointment.[2]

"We do hold that the board having authority to appoint for an indefinite period may appoint for a definite period and even after an indefinite appointment may exercise its authority to fix a definite period beyond which the original appointment shall have no effect, and the obligation of the bond given in connection with such indefi-

[1] 133 Ia. 147; 110 N. W. 450.

[2] Dedham Bank *v.* Chickering, 3 Pick. (Mass.) 335; Shackamaxon Bank *v.* Yard, 143 Pa. 129; 22 Atl. 908.

nite appointment cannot extend, in the absence of any language in the bond itself giving it effect, beyond such change in the term of appointment. Whatever construction may be placed on the action of the board in April, 1896, as to whether it fixed a definite term in substitution for the previous indefinite term, there can be no doubt as to the construction which should be given to the action of the board in June, 1897, when Colton was employed for the next year as cashier. By the terms of that appointment he entered upon a new term with a fixed limitation of time, and beyond the limitation of that appointment the original bond could be of no force and effect, and this was the holding of the trial court."

CHAPTER XII

(VII) DISCHARGE OF LIABILITY BY SETTLEMENT OF LOSS

§ 114. **Conditions Subsequent, the Performance of which is necessary to the Fixing of Liability of the Insurer under the Policy after the Occurrence of a Loss involving Contingent Liability under the Policy.** — The conditions here referred to may be subdivided into the following classes:

(A) Conditions relative to notice of loss.

(B) Conditions relative to proof of loss.

(C) Conditions relative to the Prosecution of the "Risk" after Liability is incurred.

(D) Conditions governing the right of subrogation as between the insurer and the insured.

(E) Conditions relative to arbitration of the question of liability between the insured and the insurer.

(F) Condition limiting the liability of the insurer to the insured with respect to suits brought for the purpose of enforcing liability for losses, to those actions only which shall be commenced within a designated period after the first discovery of the act or default upon which such action may be based.

§ 115. (A) **Conditions Relative to Notice of Loss.** — It is customary to provide in all policies of guaranty insurance that

notice of loss shall be given to the insurer by the insured within a certain designated time. The time here referred to is usually controlled by the use of such phrases as "immediate notice," "notice forthwith," "as soon as practicable," "as soon as possible," etc. These phrases have practically one and the same meaning, to wit, that the insured shall with all promptitude considering the probable amount of the loss, and the probablity of the "risk's" endeavoring to escape, give notice to the insurer of the occurrence of the loss. With respect to giving notice of loss, the object sought to be obtained thereby is not so much the particulars of the loss as the mere naked fact that a loss has occurred, for which under the policy as claimed by the insured the insurer is liable.

This entire subject of notice of loss has been already fully considered herein under the title "Conditions requiring Immediate Notice to the Insurer of any Act on the Part of the 'Risk' that may involve a loss for which the Insurer is responsible under the Policy."[1] Therefore, in this immediate connection but little need be added to what has already been said.

In Commercial Mutual Building Society *v.* London Guaranty and Accident Company,[2] where the policy provided that notice should be given to the insurer of the "risk's" fraud or dishonesty, and the defalcation was not discovered until after the policy had expired, and the company was not notified thereof until eleven days after the discovery of such defalcation, when the "risk" had then left the country, a recovery was denied. It has been suggested in a recent case that the insured is entitled to a reasonable time in which to investigate the question as to whether or not the "risk" has been guilty of such defaults as give rise to a liability under the policy before giving notice thereof to the insurer.[3]

With respect to the character of the notice of default required under a policy wherein was contained a clause providing

[1] See *ante* § 103. See also Roark *v.* City Tr. Safe Dep. & Sur. Co., Mo. App. ; 110 S. W. 1.

[2] 1 Montreal L. R. 7 Q. B. 307.

[3] Bank of Tarboro *v.* Fid. & Dep. Co. of Md., 128 N. C. 336; 38 S. E. 909.

"that the insured should immediately give the insurer notice in writing of the discovery of any loss or default thereunder, and should file with the insurer his claim thereunder with full particulars thereof as soon as practicable thereafter" the case of Fidelity and Deposit Company of Maryland *v.* Courtney[1] is in point. Here a notice of loss was given referring to the policy by number, and informing the insured that the "risk" had been found in default to the insured, and that the full amount of indemnity named in the policy would be required of the insurer. The notice was held to be sufficient inasmuch as its purpose was to enable the insurer to terminate its liability and to obtain such remedies as it might see fit to adopt against the defaulting "risk." While the notice sent was general in its character, it advised the insurer of the default, claimed the full amount of indemnity, and no objection as to its sufficiency was made by the insurer when received. In this same case the further question was considered as to what constitutes the giving of notice as soon as practicable after the discovery of a default. On this subject, the court spoke as follows:

"Upon the question of notice of McKnight's default it is strenuously argued that the notice given by the receiver after he took possession of the bank is not such notice as is required, and for that reason there can be no recovery upon the bond. The bank was closed on the 17th of January, 1897. The receiver was appointed on the 22d of January, 1897. On the 18th of February the receiver gave the following notice:

"LOUISVILLE, KY., February 18, 1897.

"To the Fidelity and Deposit Company of Maryland, Baltimore, Md. — Gentlemen: Referring to the certificate No. 4043, issued from your security department, guaranteeing the fidelity of Jacob M. McKnight, president of the German National Bank, under your bond to him, No. 5002, issued June 1, 1894, in favor of such bank, we hereby notify you that said Jacob M. McKnight, as president, has been found in default to this bank, and that you will be required to make indemnity to me as receiver to the extent of said bond.

"Yours truly,

"R. H. COURTNEY, Receiver, German National Bank.

[1] 103 Fed. 599; 43 C. C. A. 331; 186 U. S. 342; 46 L. E. 1193.

"When this notice was offered in evidence, it was objected to, the attorney for the defendant stating: 'We have no doubt he sent it [the notice], and make no point on that, but we desire to object to the admission of it, as not being the notice required in the contract, and therefore we received no notice whatever.' . . .

"If they began to discover the shortages two or three weeks after the bank was closed, that would mean the discovery was first made between the 2d and 9th of February, 1897. The court left this question to the jury under the following instructions:

"'The defendant insists upon this clause of the contract between it and the bank that "the employer shall immediately give the company notice in writing of the discovery of any default or loss hereunder, and shall file its or their claims hereunder, with full particulars thereof as soon as practicable thereafter, and no claim which shall not be so filed by the employer with the company within six months after the expiration or cancellation of its bond, or within six months after the employee shall have ceased to be in the employer's service, shall be payable hereunder." In considering that clause of the contract between these parties, I do not think the word "immediately" should be given such construction as that it would mean instantly, but I believe it conforms with the views of the Supreme Court and the authorities generally to tell you that it means that it was the duty of plaintiff in this case to give, as soon as reasonably practicable, and with promptness, notice of the discovery of any default. It did not mean that as soon as one was suspected that notice should be given; but if you believe, from the evidence, that within a reasonable time after the receiver in this case (and you must remember that he is the receiver merely, and that he knew nothing about the management of the bank, nothing of its affairs, until he was appointed), if you believe that, within a reasonable time after he discovered — actually discovered — a default, he gave the notice of the 18th day of February, 1897, you are at liberty to infer that that part of the obligation of this bond has been performed.' The court of appeals in its opinion in the case [1] spoke as follows:

"We think there was not such a lapse of time from the time the receiver began to discover these defaults until he gave the notice of February 18, 1897, as would require the question to be taken from the jury. We have already said no notice is required until the bank had knowledge of facts which would justify it in charging dishonesty. . . .

"Unless the lapse of time is so long as to be obviously a non-compliance with the contract, the question is one for the jury. . . .

[1] 103 Fed. 599; affirmed by U. S. Sup. Ct. in 186 U. S. 342.

"The word 'immediate' is certainly no stronger than the word 'forthwith' or the expression 'as soon as possible.'

"Assuming that the defalcations were becoming apparent to the experts so that they began to discover two or three weeks after the bank was closed, we cannot say, as a question of law, that such facts had been discovered as would justify a prudent man in charging another with dishonesty so as to require notice, and we think the question was properly left to the jury under the instructions given. Some cases have been cited in which it seems a more restricted view of this requirement is taken, but we think the opinion here expressed is more consonant with the intention of the parties and the purposes of indemnity contracts. In Bouvier's 'Law Dictionary' it is said of the word 'immediate,' 'Strictly it implies not deferred by any loss of time, but as usually employed it is rather within reasonable time, having due regard to the nature and circumstances of the case.'"

Commenting on the sufficiency of the form of notice, the court spoke as follows:

"Nor do we think there is any reasonable objection to the form of the notice given. The purpose of the notice was to enable the indemnity company to terminate its liability, and to obtain such remedies as it might see fit to adopt against the defaulter. The notice sent was general in its character. It advised the company of the default, claimed the full amount of indemnity, and no objection was taken to it." [1]

The Supreme Court of the United States has held [2] that the requirement of a fidelity bond, obligating the insured to give immediate notice to the insurer of any default of the risk therein named for which the insurer was liable, is fulfilled by giving the notice as soon as reasonably practicable under the circumstances of the case.

Thus notice that a bank official was a defaulter given the "surety company" on his bond within from ten to seventeen days after the first discovery of the default, cannot be said as a matter of law, not to have been given as soon as reasonably practicable.[3]

[1] Fid. & Dep. Co. *v.* Courtney, 103 Fed. 599; 186 U. S. 342; 46 L. E. 1193.

[2] Fid. & Dep. Co. of Md. *v.* Courtney, 186 U. S. 342; 46 L. E. 1193.

[3] *Idem.*

In a recent Kentucky case [1] it was held that under a fidelity insurance bond requiring immediate notice to be given to the insurer on the discovery of any act of fraud or dishonesty on the part of the "risk" where the items of such "risks" fraudulent accounts were discovered on April 7, and attempts were made up to April 17 to settle these accounts with the "risk's" family, that notice had not been given within such time as was required by the condition of the policy, requiring immediate notice. In rendering its opinion in this case, the court spoke as follows:

"Concerning such questions under guaranty insurance, Frost Guaranty Insurance, Section 104, says: 'It is customary to provide in all policies of guaranty insurance that notice of loss shall be given to the insurer by the insured within a certain designated time. The time here referred to is usually controlled by the use of such phrases as "immediate notice," "notice forthwith," "as soon as possible," "as soon as practicable," etc. These phrases have practically one and the same meaning, to wit: that the insured shall, with all promptitude, considering the probable amount of the loss and the probability of the "risk's" endeavoring to escape, give notice to the insurer of the occurrence of the loss.' The employer is not bound to report his suspicions to the insurer, even though they be strong enough to justify, in the opinion of the employer, the discharge of the employee. If suspicion is raised, he ought to pursue his inquiries with reasonable diligence, and when satisfied that the defalcation exists and the extent or the substantial extent thereof, then notice of the fact should be given promptly to the insurer. Notice of each item found in the course of an examination need not be given. This, we think, is the reasonable construction of the clause in the bond."

In the case of Remington *v.* Fidelity and Deposit Company of Maryland,[2] the facts were as follows:

An employee's fidelity policy required that if the insured without previous notice to and the consent of the insurer entrusted the "risk" with money or property after the discovery of his dishonesty, then the policy should be forfeited. The employer discovered the defalcation of his bookkeeper on

[1] Fid. & Guar. Co. *v.* Western Bank, 29 Ky. L. R. 639; 94 S. W. 2.

[2] 27 Wash. 429; 67 Pac. 989.

August 20 of the year covered by the policy. His office was large, and in such a condition that he could find no one to take charge of the office, but he finally secured another bookkeeper, who could not report for several days. In the meanwhile he was called out of the city on business, and left the defaulting bookkeeper in charge, who, in his absence, forged several checks. Notice of the bookkeeper's dishonesty was sent to the insurer on October of the same year. Under this state of facts the court held that the insurer was not liable for any defalcations occurring after the discovery of the default.

In Perpetual Building and Loan Association *v.* United States Guaranty Co.,[1] it was held that a delay of six or eight days in notifying the insurer of the "risk's" defalcation where no material injury resulted therefrom, was not as a matter of law a violation of the conditions of the bond under which the "risk" was bonded, requiring immediate notice.

It further appeared in this case that the "surety company" on receiving notice of the defalcation referred to had sent an inspector to ascertain the injury and extent of the delinquencies of the employee. It further appeared that the surety company had authorized such inspector to assist in an examination of the "risk's" books by an expert accountant employed by the insured. The court held that the "surety company" was charged with notice of what was going on and likely to be ascertained, at least in so far as to constitute waiver of notice of defalcation subsequently discovered until the examination had been completed. This, even though the bond required immediate notice. The court made an incidental holding in this case to the effect that an agent of the "surety company" had authority to waive notice of the "risk's" defalcations, even though prohibited from so doing by his contract with the "company." The court in constructing such a condition spoke as follows:

"Immediate is defined to be without unnecessary or inexcusable delay under all circumstances. In a case like this, some time may

[1] 118 Ia. 729; 92 N. W. 686.

elapse after a well-grounded suspicion, before the employer had any assurance on which to make any charge of fraud or dishonesty. Mere laches or inefficiency in business, consistent with integrity, is not enough. Knowledge of defalcation frequently depends on a wrong draft of funds or the examination of extended accounts. Discrepancies or irregularities confirmatory in themselves of guilt, are often unexplainable, but turn out to be entirely consistent with innocence. The confidence of years is not ordinarily shaken in an instant and the employer is difficult to convince of the depravity of the person whom he has manifestly trusted. Unjust inferences and false accusations are always to be avoided. The truth, only after being ascertained with reasonable certainty, can be safely made known. Character is too sacred to permit of tolerating a less liberal rule. It is only of acts which may create a loss for which the surety is responsible — that is, a loss arising from fraud or dishonesty — that immediate notice is exacted."

This entire matter of what constitutes due notice was given full consideration by the United States Circuit Court of Appeals (eighth circuit) in Ætna Indemnity Company *v.* J. R. Crowe Coal and Mining Company.[1] In this case the bond sued upon required that the insurer should be notified in writing of any fraudulent or dishonest act on the part of the risk which might involve a loss for which the company would be responsible, immediately after the occurrence of such act should have come to the insured's knowledge. The court held that the notice required was one which charged the "risk" with the commission of a felony, and hence the employer was not bound to give such notice until it had acquired knowledge sufficient to justify a reasonable man in making such a charge. In an elucidation of this holding the court spoke as follows:

"The contract of indemnity obligated the defendant to reimburse plaintiff for the pecuniary loss it might sustain by reason of fraudulent or dishonest acts of Graves amounting to embezzlement or larceny. The notice required to be given was, in the language of the contract, 'of any fraudulent or dishonest act of Graves involving a loss for which the company is respŏnsible;' that is, a loss arising out of embezzlement or larceny by the employee. This notice was required to be given, not immediately after fraudulent or dishonest acts amounting

[1] 154 Fed. 545.

to embezzlement should be committed, but only 'immediately after the occurrence of such act should have come to the knowledge of the employer.' From this analysis of the contract it appears that the notice required was one that would charge the employee with the commission of a felony, and was required to be given only after knowledge should have come to the employer of the commission of such offence.

"The authorities place a reasonable and practical construction upon contracts of the kind in question, one in which the rights of both parties are fairly respected and protected. The serious effect of making a criminal charge upon the character, business and social standing and future prospects of an employee as well as a proper appreciation of the personal responsibility assumed in making a false charge by an employer, reasonably call for care, circumspection and caution in making it. Immediate notice — that is, literally speaking, instant notice — is not required to be given, but only such notice as reasonable diligence under all the circumstances of the case dictates, after knowledge of the facts requiring it, is obtained. And this is not required to be given on mere rumor of irregularities or suspicion of dishonesty; neither is absolute or complete knowledge of an accomplished crime necessary; the employer is required to get only such knowledge of facts as would justify a careful and prudent man in believing a crime to have been committed."

§ 116. (B) **Proof of Loss.** — The following is a common provision with reference to the furnishing of proof of loss by the insured to the insurer, to wit:

"That the insurer within three months from the date of the discovery of any act or default of the 'risk' that may give rise to a claim under the policy, shall deliver to the insurer an itemized account of any loss or damage covered by this policy, thereby caused to the insurer, together with an affidavit in writing by the proper officer of the insured, confirming the correctness thereof; and if required, shall produce in support thereof for investigation by the insurer or its representative, all appropriate books, vouchers and such other evidence as may be reasonably required by the insurer, and until such books, vouchers, and evidence (if required) have been furnished to the insurer, no claim shall be payable under this policy by the insurer to the insured."

There can be no doubt but what the furnishing of a satisfactory proof of loss, as required by the policy, is a valid condition precedent to any attempted enforcement

of liability under such a policy by the insured as against the insurer.[1]

The policy should always be referred to for the purpose of ascertaining when the proof of loss should be filed with the insurer. With respect to this the date of the discovery of the loss by the insured is usually named as the date of commencement of the time limited for furnishing proof of claims. Another common provision in this same connection is that one, requiring proof of loss to be furnished in any event within a certain period of time after the expiration or cancellation of the policy. All such provisions while unquestionably reasonable and valid, are to be liberally construed so as not to work unnecessary hardship upon the insured.[2]

In the case of the Fidelity and Deposit Company *v.* Courtney,[3] the court observed:

> "It was further objected at the trial that the proof of claim, which was required by the policy to be made out as soon as practicable after the default, was not furnished in time. This claim was filed in July, 1897. During all the intervening time the investigation was going on and the books of the bank were being examined. So far as the testimony discloses the full particulars of the claim were not developed until July so as to be capable of proof."

On this state of facts the court held that proof of claim under the bond, required to be filed with the surety company with full particulars as soon as practicable after the giving of written notice of a default or loss, is filed in time when made as soon as practicable after the full particulars of the default are ascertained.[4]

Again, it was said in the case of the Fidelity and Casualty Company of New York *v.* Gate City National Bank [5] that where the policy contained an express stipulation, providing

[1] F. & C. Co. of N. Y. *v.* Gate City Nat. Bank, 33 L. R. A. 821; 97 Ga. 634; 25 S. E. 392; Sloman *v.* Mer. Cr. Guar. Co., 112 Mich. 258; 70 N. W. 886.

[2] Am. Sur. Co. *v.* Pauly, 72 Fed. 470; 170 U. S. 133.

[3] 103 Fed. 599; 43 C. C. A. 331.

[4] Fid. & Dep. Co. *v.* Courtney, 186 U. S. 342; 46 L. E. 1193.

[5] 32 L. R. A. 21; 97 Ga. 634; 25 S. E. 392.

for proof of loss satisfactory to the insurer, and that notice, with full particulars of any claim arising under the policy, should be given in writing to the insurer within a specified time, and the declaration filed by the insured in an action on the policy, alleged compliance with the foregoing terms of the policy, but did not allege that there had been any waiver of the requisite proof of loss, and the evidence entirely failed to show that the same had been duly furnished, that this was sufficient to justify a nonsuit in favor of the insurer under the terms of the policy in suit. In a late federal case it was held that notice of default referring to the policy issued by the insurer and informing the insured generally that the "risk" was a defaulter to the full amount of the policy, is sufficient in form to meet all the requirements of the policy, providing that upon the discovery of any default the insured should give notice to the insurer in writing.[1]

The purpose of the notice, as we have seen, is to enable the insurer to terminate its liability, and to obtain such remedies as it might see fit to adopt against the defaulter. The notice sent, though general in its character if it advises the insurer of the default, and claims the full amount of the indemnity, is sufficient.

By the terms of a fidelity insurance policy indemnifying an employer against loss by reason of the fraud of an employee amounting to embezzlement or larceny, it was a condition precedent that the insurer should be entitled to call for, at the insured's expense, such reasonable particulars and proofs of the correctness of such claims, as might be required by the officers of the insurer. Request was made by the insurer "for the names of customers from whom the 'risk' had collected money, and also of the dates when such money was collected by the employee as covered by the charge." This request was not complied with. It was held that the insured was not entitled

[1] Fid. & Dep. Co. *v.* Courtney, 103 Fed. 599; 43 C. C. A. 331; see also Molson's Bank *v.* Guar. Co. of N. A., Montreal L. Rep., 4 Sup. Ct. Rep. 376; Harbor Commissioners *v.* Guar. Co. of N. A., 22 Sup. Ct. Rep. 542 (Can.).

to recovery on the policy, in the absence of any allegation and proof of waiver or excuse for non-performance of the condition.[1]

In Globe Savings and Loan Company *v.* Employers' Liability Assurance Corporation [2] one of the conditions of the policy required that on discovery of fraud or dishonesty on the part of the "risk" the insured should immediately give notice in writing to the insured, stating the number of policy, cause, nature and extent of loss and the address, if known, of the "risk." No formal notice was sent, but information of the loss was communicated to the insurer, and it took steps to ascertain fully the facts, and this was held to constitute a waiver of this condition of the policy. It was further held that the condition of a policy requiring the furnishing of proof to the satisfaction of the insurer did not require the insured to establish to the satisfaction of the insurer the absolute liability of the latter and the absence of any defence.[3]

Where a surety company expressly denies all liability on a fidelity bond, the making of proof of loss is waived.[4]

Where proofs of loss under a fidelity bond were received within the time required by the contract and retained by the company so long that when returned with a request for new proofs of loss, the time limited for the making of proofs had expired, any objection for insufficiency of the proofs was waived.[5]

In a Canadian case, where the condition of a guaranty policy required the employer to give notice immediately to the guarantor of any criminal offence of the employee entailing loss for which a claim was liable to be made under the bond, and the employer, although aware of a defalcation on the 25th, did not give notice thereof to the guarantor until the 27th, after the employee had fled the country, it was held that the policy was forfeited.[6] In general it may be said that

[1] Weider *v.* Union Sur. Co., 86 N. Y. Sup. 105.

[2] King's Bench, Manitoba, 1901, 37 Can. L. J. 511.

[3] See also dissenting opinion of White, J., in Am. Sur. Co. *v.* Pauly, 170 U. S. 160.

[4] Sinclair & Co. *v.* Nat. Sur. Co., 132 Ia. 549; 107 N. W. 184.

[5] *Idem.*

[6] Molson's Bank *v.* Guar. Co. of N. A., Montreal L. Rep., 4 Sup. Ct. Rep. 376.

whether notice of loss was given within a reasonable time is a question of fact for the jury.[1]

An interesting case on the probative and legal effect of evidence tending to establish proof of loss in suits brought by the insured against the insurer is that of Supreme Council of Catholic Knights of America *v.* Fidelity and Casualty Company of New York,[2] where the facts were as follows: On the reappointment of the treasurer of a beneficial association for a new term, a surety company gave to the association its bond to make good such pecuniary loss, if any, as might be sustained by the employer by reason of fraud or dishonesty of the employed in connection with his duties referred to, amounting to embezzlement or larceny, which was committed and discovered during the continuance of such term or renewal thereof. It was contended, on the part of the insured, that in an action on the bond certain entries, receipts and reports, made by said treasurer during the life of the bond, in the ordinary course of his duty as treasurer, charging himself with certain items, was conclusive against the insurer as to the time when such items were received. On this point the circuit court of appeals (sixth circuit) spoke as follows:

"Undoubtedly there may occur cases in which the official should be estopped by his entries and reports in consequence of several circumstances appearing constituting estoppel *in pais.* In such cases the surety would be bound by the evidence which concluded his principal, but such estoppel should only arise on bonds conditioned on the faithful performance and discharge of the duties of the office. So under bonds obligating the surety for the faithful discharge of official duties by his principal, the evidence offered to show fabricated entries or false representations may show such official dereliction or fraud as in itself would constitute breach of the obligation of the bond. The bond now in suit is not the bond of a sworn public officer,

[1] Har. S. & L. Ass. *v.* U. S. Fid. & Guar. Co., 46 Atl. 910; 197 Pa. St. 177; Am. Sur. Co. *v.* Pauly, 72 Fed. 470; 170 U. S. 133, 165; F. & C. Co. of N. Y. *v.* Weise, 80 Ill. App. 499; see generally Hall *v.* U. S. Fid. & Guar. Co., 77 Minn. 24; 79 N. W. 590; Guar. Co. of N. A. *v.* Mut. Bldg. & Loan Ass., 57 Ill. App. 254.

[2] 63 Fed. 48; 11 C. C. A. 96.

and in a more important particular still is it distinguishable from public official bonds. It is this: All those bonds bind the sureties for the faithful performance of the duties of the office occupied by their principal. The bond in suit is remarkable in that the only obligation of the surety is that it will make good and reimburse such pecuniary loss, if any, as may be sustained by the employer by reason of fraud or dishonesty of the employed in connection with the duties thereof and amounting to embezzlement or larceny which may be committed and discovered during the continuance of the term or any renewal thereof, and within three months from the death, dismissal or retirement of the employed. No circumstances tending to make out an estoppel *in pais* appear in this case. The general secretary of the order, who audited the claims and who drew the drafts on the treasurer for their payment, was not dependent alone upon the reports of the treasurer as to either the amounts or dates of his receipts. Under the laws of the association the subordinate lodges, called branches, sent to the secretary duplicates of all letters of remittance to the treasurer on printed forms required to be issued. From this duplicate notice the treasurer was enabled to learn when and what remittances had been received by the secretary. The insistence of the plaintiff is barren of all circumstance which would tend to move the conscience of the court, and is, in substance, this: 'It may be true that the $21,000 with which I seek to charge you, in addition to the sum adjudged against you, did not come to O'Brien's hand during the term covered by your bond, and that he in fact embezzled that sum before you undertook to guarantee his honesty, yet he has made entries on my books, executed receipts and written letters of advice while you were on his bond, whereby he admitted this sum did come to his hands during the currency of the bond, and you should not be allowed to show that he did not receive and embezzle that money at the dates he has admitted that he did receive it.' There is neither sound morals nor natural justice in this effort to shut out the truth and fix the liability on the defendant for a defalcation occurring before it became obligated as a surety. Neither is there any principle of public policy or settled law which would close the door on the truth under a bond such as that here involved."

In connection with the general subject of "proof of loss," it may be proper to present here some allied questions of evidence that constantly arise in actions brought to enforce liability under fidelity bonds.

In an action on a fidelity insurance policy indemnifying the

employer against loss by reason of the fraud or dishonesty of an employee amounting to embezzlement or larceny, the declarations of the "risk" made after the alleged embezzlement are not binding on the insurer.[1]

On the other hand, the admissions of the "risk" in a fidelity bond, with respect to the matters pertaining to the performance of his guaranteed duties, made while he is in their discharge, is competent evidence against the surety on his bond. In the case of Guarantee Company of North America *v.* Phœnix Insurance Company of Brooklyn,[2] the principal in the bond was the cashier of the plaintiff and the defendant was the surety on his bond. Upon the last day of his employment, but before that employment had ceased, he admitted to the agent of the plaintiff that he was guilty of the embezzlement of the proceeds of checks which belonged to plaintiff and which formed a part of the basis of the latter's cause of action. The agent to whom this admission was made was allowed to testify about it, over the objection of the defendant. The court held that the evidence was competent, and denied a motion to strike this testimony from the record.

In an action on an employer's indemnity bond the burden is on defendant to show the falsity of any statements contained in a previous application, and defendant cannot rely on the falsity of statements in plaintiff's application where such defences have not been pleaded.[3]

Where the insurer in an employer's indemnity bond made no objection on the ground that it had not been immediately notified of the "risk's" embezzlement, but called on the insured to make an effort to effect a settlement with the "risk" and then required him to make an itemized proof of loss and specially called on the insured to take steps for the criminal prosecution of the employee, the court held that the failure to give immediate notice was waived.[4]

[1] Wieder *v.* Union Sur. Co., 86 N. Y. Sup. 105; 42 Misc. 499.

[2] 124 Fed. 170; 59 C. C. A. 376; 187 U. S. 640.

[3] Goldman *v.* Fid. & Dep. Co. of Md., 125 Wis. 390; 104 N. W. 80.

[4] *Idem.*

In an action on an employer's indemnity policy, entries of the "risk" and reports and statements made in the course of his duties in the employment are admissible in evidence against the insurer.[1]

The probative effect of a judgment previously obtained by the insured against the "risk," upon the question of the insurer's liability for the same claim evidenced by such judgment, is discussed at length in Union Guaranty and Trust Company *v.* Robinson,[2] which, though a case relating to a policy of contract insurance, is not without its application here.

A policy had been given by a "surety company" conditioned upon a due payment of all its obligations in the state of Arkansas by a foreign fire insurance company doing business in that state. Judgment was obtained by one of the beneficiaries under the policy against said company on a fire insurance policy issued in Arkansas. It was held that such judgment was, if not conclusive against the "surety company," at least *prima facie* evidence of its liability under the policy to such beneficiary. The court, in its opinion, said:

> "When one is responsible by force of law or by contract for the faithful performance of the duty of another, a judgment against that other for a failure in the performance of such duty, if not conclusive, is *prima facie* evidence in a suit against the party so responsible for that other. If it can be made to appear that such judgment was obtained by fraud or collusion, it will be wholly set aside, but otherwise it is *prima facie* evidence, to stand until impeached or controlled in whole or in part by countervailing proof."

It goes without saying that the insurer is not bound to accept the insured's unsupported statement that a certain loss has occurred, but may, of course, insist that all claims shall be supported by competent proof, according to the rules of evidence, or under the provisions of the policy relative to such matters.[3]

Thus it is usually provided that full particulars of all claims

[1] *Idem.*

[2] 79 Fed. 420; 24 C. C. A. 650.

[3] Levy *v.* Fid. & Dep. Co., 87 N. Y. Sup. 481.

under a policy, accompanied by an itemized account of the same, shall be furnished. To this is sometimes added the further provision that all claims shall be accompanied by an affidavit in writing by the auditor or proper officer of the insured, confirming the correctness of such claims, and if required, there shall be produced in support thereof for investigation by the insurer all appropriate books, vouchers and such other evidence as may be called for. The reasonableness of such provisions is obvious for the following reasons:

1st. It is right that the insurer should know that the claim filed is a valid one based upon facts.

2d. The insurer should know whether the insured has in his possession sufficient evidence to establish a loss beyond the point where it ceases to be conjecture, and becomes an established fact.

3d. It is of material benefit for the insurer to have presented to him all the evidence of loss in the insured's possession that he may take immediate steps, with this in hand, to secure reimbursement from the "risk" for the amount of the claim which it is under a legal liability to pay. Yet in this connection it should always be remembered that proofs of loss in guaranty insurance should always be construed liberally and not closely, with the same degree of legal and technical accuracy as pleadings.[1]

Sometimes a policy makes a provision that a certain form of proof shall be *prima facie* evidence of liability under the policy. Thus the following clause is found inserted in some guaranty policies at the present day, to wit:

"Now, therefore, in consideration," etc. . . . "it is hereby declared and agreed that subject to the provision herein contained, the company shall, within three months next after notice, accompanied by satisfactory proof of loss, as hereinafter mentioned, has been given to the company, make good and reimburse to the employer all and any pecuniary loss sustained by the employer of money, securities or other personal property in the possession of the employee, or for the possession of which he is responsible, by any act of fraud or dis-

[1] Am. Sur. Co. *v.* Pauly, 72 Fed. 470; 170 U. S. 133, 160.

honesty on the part of the employee in connection with the duties of the office or position hereinbefore referred to, or the duties to which, in the employer's service, he may be subsequently appointed, and occurring during the continuance of this bond, and discovered during said continuance, or within six months thereafter, and within six months from the death or dismissal or retirement of the employee from the service of the employer. It being understood that a written statement of such loss, certified by the duly authorized officer or representative of the employer, and based upon accounts of the employee, *shall be prima facie evidence thereof.*"

Such a provision as the foregoing was construed by the United States Supreme Court in the case of American Surety Company *v.* Pauly.[1] It appeared that the trial court below had instructed the jury as to the meaning of the *prima facie* clause as follows:

"Now there is a provision in the policy to the effect that a written statement of loss, certified by the duly authorized officer or representative of the employer (receiver of the bank in this case) and based upon the accounts of the employer, shall be *prima facie* evidence thereof. In view of that condition of the policy, I instruct you that the plaintiff has established a *prima facie* case against the defendant, because he gave the written statement of loss and subsequently transmitted to the defendant a copy of the account upon which it was based. Nevertheless the plaintiff has offered additional evidence. He might have rested his case upon the proof that he had complied with this condition of the policy which I have read to you, and insisted then that it was incumbent upon the defendant to show that the bank had not sustained a loss within the terms of the policy. But the plaintiff has seen fit to produce further evidence."

This instruction was claimed to be erroneous, and it was for this reason reviewed by the appellate court as follows:

"The surety company insists that the provisions of the bond referring to the written statement of loss relate exclusively to the presentation of the claim to the company, and its acceptance or rejection thereof, and not to the use of such statement as independent evidence, in any suit brought for the recovery of such loss; in other words, it is argued, the company was willing, in its consideration of the claim of loss, to accept as *prima facie* proof of the claim the state-

[1] 170 U. S. 160.

ment of loss duly certified, and based upon the account of the employer, but did not waive its right, if sued, to demand such proof as was necessary in law to sustain it. The bond may be susceptible of this construction. But is it not also susceptible of the construction placed upon it by the trial court? If the surety company intended that the written statement of loss certified by the duly authorized officers or the representatives of the employer, and based upon the accounts of the employer, should be *prima facie* evidence only of the right of the employer to bring suit on the bond if its claim of loss was not paid, it should have expressly so declared. But that was not done. The company agreed to pay any loss covered by the bond within the three months next after notice accompanied by satisfactory proof of loss. But that no doubt might arise as to what was satisfactory proof of loss, and that the obligee might be assured of the prompt settlement of any claim it might make under the bond, if accompanied by proper proof of loss, care was taken to express the understanding that the written statement of such loss, duly certified and based upon the accounts of the employer, should be *prima facie* evidence thereof, that is, evidence of such loss. In our judgment the circuit court of appeals correctly held that the interpretation placed upon the bond by the trial court was the natural one. The company might well have agreed that in the event of a suit, a written statement of loss arising from the fraud or dishonesty of the employee and based upon the accounts of the employer, should be sufficient, nothing appearing to the contrary, to establish the loss; and this for the reason that such accounts, if the claim was disputed and made the subject of suit, would be open to examination by the company. The employer would not base its statement on its own accounts, and then withhold such accounts from inspection by the obligor of the bond.

"If the latter construction of the bond be not clearly right, it cannot be said to be inconsistent with its provisions. And it would be going very far to say that the construction given to it by the company was so clearly right that a different construction would be unreasonable or entirely inadmissible. We have then a contract so drawn as to leave room for two constructions of its provisions, either of which may be conceded reasonable, — one favorable to the company, and the other favorable to the bank, — and most likely to subserve the purposes for which the bond was given. In such a case the terms used must be interpreted most strongly against the party who prepared the bond, and delivered it to the party for whose protection it was executed. It has been so held in the case just decided."

In this same case it was said to be sufficient proof of loss to state (under a policy having the *prima facie* clause above referred to) by way of proof "that on the thirteenth day of October, he, the said J. W. Collins (the 'risk'), obtained from the United States Bank of New York a loan of $5000, upon a note of the California National Bank (the insured), and by rediscounting certain individual notes, being of the assets of said bank, took and applied said sum of $25,000 to his individual use and embezzled said sum."

Where the petition in an action on an agent's bond alleges that a proper statement of loss by the insured of the misconduct of the agent was made to the surety, as required by the bond, it is not error to deny a motion to make more specific by stating whether the account attached to the petition is a copy of such proof of loss.[1]

Where the insured in an indemnity policy stipulates that the insurer shall have the right to inspect the books of the insured for a proper purpose, relating to matters covered by the policy, such insured is estopped to assert that an order made by the court, permitting such inspection is an unreasonable search or seizure of the insured's books in violation of the fourth amendment to the Constitution of the United States, guaranteeing parties against unreasonable searches and seizures.[2]

It is now proposed to offer some general rules relative to the subject of the manner and mode of proving loss under policies of fidelity insurance. These are now presented as follows:

(1) The proof of loss must be reasonably full and complete, or liability under the policy may be avoided under the customary clause, which provides that until such proof is furnished no claim shall be payable under the policy.[3]

[1] Dr. Blair Medical Co. *v.* U. S. Fid. & Guar. Co., Ia. ; 89 N. W. 20.

[2] Swedish Am. Tel. Co. *v.* F. & C. Co., 208 Ill. 562; 70 N. E. 768; see also in general as to proof of claim the following cases: Sup. Ruling of Fraternal Mystic Circle *v.* Nat. Sur. Co., 99 N. Y. Sup. 1034; Union Pacific Tea Co. *v.* U. S. Guar. Co., 86 N. Y. 466.

[3] See Am. Sur. Co. *v.* Pauly, 72 Fed. 470.

(2) Where a verification of proof is provided for in the policy, it must be made, if required by the insurer.

(3) The best possible proof, consistent with the nature of the loss and existing circumstances, must be furnished.

(4) All books and accounts, entries, reports and admissions of the "risk" are admissible in support of the insured's claim, in so far as the same relate to the matter in issue.[1]

(5) If the insured, in support of his claim, proves that the "risk" has received a certain amount as a sum total, and that he has returned or accounted for a less amount only, this shifts the burden of proof and becomes conclusive, if not rebutted.[2]

(6) All provisions of the policy, as to mode and manner of proof, are binding upon both the insurer and the insured. Yet, unless made exclusive, they do not forbid other competent proof of the loss.

§ 117. (C) **Conditions relative to the Prosecution of the "Risk" after Liability is incurred.** — Most fidelity insurance policies contain a provision that the insured shall if required by the insurer, and as soon thereafter as it can reasonably be done, give all such aid and information as may be possible (at the cost and expense of the insurer) for the purpose of prosecuting and bringing the "risk" to justice, or for aiding the insurer in suing for and making an effort to obtain reimbursement by the insured of any moneys which the insurer shall have paid, or become liable to pay, by virtue of the issuance of any policy. To the foregoing is sometimes added a provision that the insurer shall, if it so elects, have the entire charge of the prosecution of the "risk" on account of any act of fraud or dishonesty covered by the policy. Then, as if to make the foregoing conditions extremely rigorous, the policies usually

[1] Hall *v.* U. S. Fid. & Guar. Co., 77 Minn. 24; 79 N. W. 590; Ind. School Ins. etc. *v.* Hubbard, *et al.*, 110 Ia. 58; 81 N. W. 241; Standard Oil Co. *v.* F. & C. Co. of N. Y., 51 S. W. 571; 21 Ky. L. Rep. 399; S. R. F. M. C. *v.* Nat. Sur. Co., 114 N. Y. App. Div. 689; 99 N. Y. Sup. 1033.

[2] Walker *v.* Brit. Guar. Ass., 18 Q. B. 277; Standard Oil Co. *v.* F. & C. Co. of N. Y., 51 S. W. 571; 21 Ky. L. Rep. 399; F. & C. Co. of N. Y. *v.* Eickhoff, 63 Minn. 170; 65 N. W. 351.

provide that prosecution to conviction of the "risk" by the insured, when required by the insurer, shall be a condition precedent to the recovery of the amount of any claim under the policy. The question now arises, whether such provisions as have been just referred to are valid to the extent of depriving the insured of any right of recovery under the policy, upon his refusal to make a complaint before the proper officer of the law for the purpose of obtaining the issuance of a warrant for the arrest of the "risk," thereby displaying an unwillingness to use due diligence in prosecuting the "risk" criminally. Of course, the question has a twofold aspect: one when reference is had particularly to criminal prosecutions, and the other in its relation to the prosecution of a civil suit by the insured against the "risk." The question now before us has rarely come before the courts for judicial determination. In London Guaranty Company *v.* Fearnley,[1] it was held that the failure to prosecute criminally, when requested, was a condition precedent to a recovery by the insured against the insurer under the policy, although that part of the condition which referred to assistance in the prosecution of a civil suit, was a condition subsequent.

A condition assented to by the insured, to use due diligence in prosecuting the person whose fidelity is guaranteed for criminal defalcation, does not require that the former shall bring the latter back from without the jurisdiction of the court.[2]

A provision in a policy insuring the fidelity of employees, that the employer shall, if required by the insurer, but at its expense, if a conviction is sought, use all diligence in prosecuting the employee to conviction for any embezzlement committed, is reasonable; and no recovery can be had from the insurance company where the employer fails, on request, to prosecute the defaulting employee.[3]

[1] Law Reports, 5 House of Lords App. Cas. 911.

[2] Dougherty *v.* London Guar. & Acc. Co., 6 Vict. T. R. Law, 376.

[3] La Canadienne Compagnie Assur. Sur. la Vie *v.* London Guar. & Acc. Co., 9 Rap. Jud. Quebec B. R. 183; 16 Rap. Jud. Quebec C. S. 78; see also generally Globe Sav. & Loan Co. *v.* Emp. Lia. Assur. Co., King's Bench, Manitoba, 37 Can. L J. 511.

The insurer is not discharged by failure of the insured to sue civilly the "risk" when notified by the insurer to do so, after the former has absconded from the state and left no property therein, so that service could not be had on him, the insured not being required to go out of the state to sue him.[1]

In Union Pacific Tea Company *v.* United States Guarantee Company,[2] the court had occasion to construe a clause of a fidelity bond reading as follows:

"The insured shall, when required by the insurer, and at the latter's expense, use all diligence in prosecuting any employee to conviction in any fraud or dishonesty which he shall have committed and in consequence of which a claim shall have been made under the bond, and the same shall be a condition precedent to recovery under the bond."

The court, in commenting upon the foregoing clause, spoke as follows:

"The defendant claims that the foregoing provision requires plaintiff to show that both its employees were prosecuted to conviction. As to the employee Taylor, it was sufficiently made to appear that the defendant made no request for his prosecution by the plaintiff. As to the employee French, it appears that upon the request of the defendant the plaintiff made a complaint against French, who was arrested and held for appearance before the grand jury. Plaintiff's agent thereafter went before the grand jury and presented proof of the fraud and the grand jury, for some unknown reason, failed to find an indictment against French and he was discharged. The court below held that all that was required of the plaintiff, when requested to prosecute the employee charged with fraud, was to use all diligence in endeavoring to secure a conviction. With this we agree. The language in the bond is that 'such action' by the employer, not 'such conviction' shall be a condition precedent to recovery; that is, that the employer shall use all due diligence in prosecuting its dishonest employee. The plaintiff could not control the criminal prosecution and could only aid the district attorney to its utmost capacity in procuring conviction. This seems to be the view originally adopted by the defendant itself of the contract if we may judge by the language of its letter to the plaintiff, admitted in evidence, in which

[1] Am. Sur. Co. *v.* Lehr, Tex. ; 93 S. W. 681.

[2] 86 N. Y. Sup. 466; 43 Misc. Rep. 50.

it asks the plaintiff to have French arrested and brought to trial, but says nothing to indicate that plaintiff must procure a conviction. Plaintiff was without power to bring French to trial, but could only lay its proofs before the grand jury which plaintiff's agent swears was done. As the contract was drawn by the attorney or agent of the defendant, it must be interpreted as to doubtful provisions in favor of the plaintiff." [1]

§ 118. (D) **Conditions governing Right of Subrogation as between the Insurer and the Insured.** — To preserve unquestioned the right of subrogation intact to the insurer, it is usually provided that in case of loss under the policy, the latter shall be subrogated, to the extent of its interest, to all claims of redress belonging to the insured in respect to such loss, and that the insured shall execute any and all papers required to secure to the insurer the said rights.[2]

The right of subrogation here reserved in express terms to the insurer is most valuable, and such provisions should be freely enforced by the courts.[3]

§ 119. (E) **Conditions relative to Arbitration of the Question of Liability between the Insurer and the Insured.** — Like other policies of insurance, the guaranty insurance policy usually provides that any question as to the liability of the insurer to pay to the insured any claim under the policy shall, if the insurer or the insured requires it, be referred to arbitration, the expense of such arbitration to be borne equally by the insurer and the insured.

The general subject of arbitration is one common to all branches of insurance law, and reference is made to general treatises on that subject for an extended discussion of the matter.[4]

§ 120. (F) **Condition limiting the Liability of the Insurer to the Insured with Respect to Suits brought for the Purpose of en-**

[1] See also Boush *v.* Fid. & Dep. Co. of Md., 100 Va. 735; 42 S. E. 877.

[2] See Dunne *v.* Am. Sur. Co., 43 N. Y. Sup. Div. 91; 34 N. Y. Misc. 584.

[3] See Rice *v.* Fid. & Dep. Co., 103 Fed. 427; 43 C. C. A. 270; see on the right of subrogation, *post*, § 281.

[4] See also Excelsior Life Ins. Co. *v.* Emp. Lia. Assur. Corp., 37 Can. L. J. 755.

forcing such Liability to those Actions only which shall be commenced within a Designated Period after the Discovery of the Act of Default upon which such Action may be based. — Nearly all policies provide "that no proceeding at law or in equity shall be brought or arbitration required to recover any amount thereby insured, unless the same is commenced and the process served within a period of twelve months next after the first discovery of the act of default upon which such claim is based." The foregoing was considered in Jackson *v.* Fidelity and Casualty Company of New York.[1]

The facts of this case were that the "risk" had fraudulently and dishonestly appropriated money to his own use between April 29, 1893, and July 1, 1893. It was provided in the policy that no suit should be brought thereon unless the same should be commenced within twelve months next after the discovery of the dishonesty on which it was based. Suit was not brought upon the policy until February 1, 1895, and as reason for the delay in bringing suit and of avoiding the limitation in the policy it was alleged that the insured bank suspended payment on July 24, 1893; that on July 26 the comptroller of the currency, by the bank examiner, took possession of all the books and assets of the bank, and on August 14 appointed a receiver; that the bank examiner alleged sundry frauds against the bank officials, of which the receiver gave notice to the insurer, but that the bank itself did not, and could not, then discover the fraud, but immediately after the suspension of the bank its officials and the majority of its directors were arrested and put under bonds on criminal charges, whereby there were no officials of the bank to make investigations or institute proceedings; that on May 24, 1894, the bank resumed business and its assets were restored to it by the receiver, though its books were retained by the district attorney, and that on May 31 the bank instituted investigations and discovered the fraud and within twelve months brought suit. It was also averred

[1] 75 Fed. Rep. 359; 21 C. C. A. 394.

that after notice of the frauds was given to the insurance company by the receiver, the company was also notified that it was impossible to give full particulars of the claims within three months. With reference to these allegations of the petition, the case coming to the court on demurrer, the latter spoke as follows:

"It is argued by the learned attorney for the defendant that the twelve months' limitation commenced to run from the first discovery of the fraudulent acts made by the bank examiner on August 14, 1893. Whatever may be said in support of the contention that a receiver appointed by the comptroller under the act of Congress in such cases ought to be considered as the representative of the bank so as to charge it with his laches in the collections of its debts, certainly no such contention can be successfully maintained as to the bank examiner. He is strictly the officer and representative of the government, and not of the bank. It was further urged, however, that the allegations are that the receiver formally acted upon the discovery of the fraud which the bank examiner alleged he had made. These averments, however, must be taken in connection with the other allegations, which show that while the receiver may, and did, have notice of the fraud committed, of which he properly gave notice to the defendant, he did not have notice of the character, extent and details of the fraud, or, in other words, he had not made such discovery of the fraud as would have enabled him to make definite claims or bring suit, and it is only after such a discovery that the statute begins to run. Of course there are cases where the insured may be charged with full knowledge of the fraud, whether there was actual knowledge of the details or not, as where the insured, after notice of the fact that some kind of fraud had been committed, through negligence failed to possess itself of the details at its command. This, however, as we shall presently see, does not apply to this case under the allegations of the declaration. These allegations are, that 'after due and proper notice of the discovery of the fraudulent acts of the "risk" was given to the defendant by the receiver of said bank, the said defendant was, through its agent in Jacksonville, Florida, duly notified that, by reason of the nature and character of the said fraudulent and dishonest acts of the said "risk," it was impossible to give in writing the full particulars of the claim made within three months after the discovery,' and that the facts were stated showing why it was impossible to get at the knowledge by details necessary to bring the suit within twelve months from the discovery of the existence

of fraud made by the examiner. If the fact that the receiver made such a statement be taken as true, as it must be on the demurrer, the truth of the statement itself will be presumed. The receiver, an officer of the government, will be presumed to have done his duty unless the contrary appears, although, like a receiver of the court, he may, in another sense, also be a representative of the parties to the suit. Even conceding that the receiver was such a representative of the bank as that the limitation against the bank in the contract would commence to run from the time when the receiver made a full discovery of the fraud, there is no admission in the declaration, when fairly construed, which shows any such discovery or knowledge on his part; and without such admission the defence, under the Florida statute, must be made by plea, and not by demurrer. The facts averred in the declaration, however, are peculiar, and seem to take this case outside of the ordinary rule which would make a receiver the representative of the bank as to the running of the period of limitation in favor of the defendant.

"The pertinent portion of the act of June 30, 1876 (19 Stat. 63), under which Stockton was appointed receiver, on August 14, 1893, provides that 'whenever the comptroller shall become satisfied of the insolvency of a national banking association, he may, after due examination of its affairs, . . . appoint a receiver, who shall proceed to close up such association,' etc. The act further provides the method of procedure by which the affairs of the bank are to be closed up. Instead of closing up the business of the association in the method pointed out by the statute for insolvent banks, the allegations of the declaration are, that on May 21, 1894, by consent and authority of the comptroller, the bank resumed business, and the money and property of the bank were restored and redelivered to it. No authority can be found in the statute for this action of the comptroller if the bank were really insolvent. In the light of the action of the comptroller, the inference from the allegations is drawn that the suspension of payments by the bank was caused by the defalcation of the officers against which the defendants had insured the plaintiff; that acting upon the fact of suspension of payments and irregularities discovered, the comptroller appointed Stockton receiver; that after giving the affairs of the bank that 'due examination' contemplated by the statute, he came to the conclusion that the bank was not solvent and that it was not a case for a receiver, as provided by statute. We have no right to infer from the allegations of the declaration that Stockton was anything more than a temporary or provisional receiver, who was never duly vested with the powers intended to be exercised by receivers of insolvent banks.

The nature of such a receivership, resulting from the very thing insured against, made it impossible for the plaintiff to obtain the knowledge necessary to make the claim and file suit at an earlier date. The character of the policies insuring the fidelity of the principal officers of the bank would prevent any laches being attributed to the bank by reason of its failure to exercise what, under other circumstances, would be diligence in getting full knowledge of such a fraud after the first suggestion of its existence is made. The fact that a majority of the directors were arrested and placed in a position where they were powerless to protect the interests of the bank under the allegations of the declarations raises no presumption against them. They are presumed to be the innocent sufferers from the acts of the guilty president and cashier until the contrary appears, and the failure of the plaintiff to act at once is due to the fact that the United States attorney took and kept possession of the books and papers of the bank to be used as evidence in a criminal case. This delay is chargeable to the government. Justice requires that the case should be treated as one in which the running of the limitation was stopped by the conduct of the insurer itself, since the delay was the direct result of the evil conduct from which the insurer contracted to protect the insured."

In the case of the California Savings Bank *v.* American Surety Company,[1] the court, in construing a somewhat similar provision, said:

"No case in point has been called to my attention, although the parties have cited many decisions, hereinafter referred to, construing the requirements of the bonds or policies respectively involved as to notice and proof of loss. Under the peculiar terms of the bond in the case at bar, however, I think no other than an affirmative answer to the question above stated is possible. Said bond provides 'that no suit or proceeding at law or in equity shall be brought to recover any sum hereby insured unless the same is commenced within one year from the time of the making of any claim on the company.' This provision, without doubt a material one, is valid. In order to be effective, however, according to the obvious intent of the parties, it must be aided by the other requirement, now under consideration, that any claim in respect to the bond shall be made as soon as practicable after the discovery of the loss, and within six months after the expiration of the bond. Thus the parties, by their contract, have made the requirement, as to the time within which the claim for a loss shall be presented, a material provision. To hold that said requirement is immaterial

[1] 87 Fed. 118.

would, in effect, annul the former unquestionably material clause, limiting the time for the commencement of suit. The bond expired June 30, 1892. No claim was made upon the company until December 16, 1895, so that the only claim made upon the company was made three years after the time when, by the contract, it should have been presented. The failure of the plaintiff to make claim within the time prescribed by the bond I think fatal to the case."

In Paris Board of Education *v.* Citizens Insurance and Investment Company,[1] it appeared that on January 1, 1879, the insured made their claim, under a policy covering only losses occurring within twelve months prior to claim being made thereunder. At the end of 1877 the default was $674, which was increased during the first two months of 1878 to $1261.57, but in the next four months the deficiency was reduced to $292.85, after which it again increased until at the end of 1878 it was $844.22.

It was held, in accordance with the general rule as to appropriation of payments, that, in the absence of any specific appropriation, the payments must be appropriated to the earliest item of the default, so that the whole amount of $844.22, due at the end of 1878, must be deemed to have accrued within that year; and that plaintiff was entitled if at all to recover that amount.

In McCallum, *et al.* *v.* National Credit Insurance Company, *et al.*,[2] it was said that when an insurance company settles and adjusts a loss with the policyholder and promises and agrees to pay the amount agreed upon such settlement, such adjustment becomes a new and independent contract, and the period fixed by the terms of the policy for bringing action thereon does not apply to the action brought upon the settlement.[3]

§ 121. (VII) **Conditions determining the Extent of Liability after the Same has become fixed save as to the Amount.** — The conditions here referred to may be divided into the following three classes:

[1] 30 U. C. C. P. 132.

[2] 86 N. W. 892 (Minn.).

[3] See also Proctor Coal Co. *v.* U. S. Fid. & Guar. Co., 124 Fed. 424.

(A) Conditions limiting liability to the amount designated in the policy.

(B) Conditions to the effect that if a claim shall be made on account of the acts or defaults of any "risk" for whom the insurer shall have been successively surety in more than one position, or for more than one amount, or for whom the insurer shall have successively issued more than one policy or renewal thereof, the insurer shall in no case be liable for the acts or defaults of such "risk" committed in more than one position, nor shall it be liable for any greater sum than the amount for which it shall have last been surety for the "risk" in the one office or position as to which a claim is made.

(C) Conditions providing that if the insured shall at the date of the policy or at any time thereafter hold any other policy or other security against the loss covered thereby in addition to such policy, the insurer shall, in the event of loss, be liable to pay only such proportion thereof as the amount of its policy bears to the amount of such other policy and other securities taken together.

§ 122. (A) **Conditions limiting Liability to the Amount designated in the Policy.** — It is a universal custom among fidelity insurance companies to insert in policies some such clause as this: "That the entire liability incurred by the insurer during the continuance of this policy or any renewal thereof, for the acts and defaults of the 'risk' herein named, shall not exceed the amount expressed in the proposal of the insured for the issuance of this policy." Under a strict wording of the foregoing clause there can be no liability on the part of the insurer that shall exceed in the aggregate the amount designated in the policy.

The principle which limits the liability of the insurer to the amount designated in the policy, as the maximum thereof, inheres intrinsically in the nature of its engagement. The insurer does not undertake to perform the duties of the "risk," whether they be of a private or public character, and is not permitted to control their performance and cannot in any

event legally assume the functions of that "risk." The undertaking of the insurer is essentially a pledge to make good the misfeasance or non-feasance of the "risk" to an amount not in excess of that named in the policy.[1]

§ 123. (B) **Conditions to the Effect that if a Claim shall be made on Account of the Acts or Defaults of any "Risk" for whom the Insurer shall have been successively Surety in more than one Position or for more than one Amount or for whom the Insurer shall have successively issued more than one Policy or Renewal thereof, the Insurer shall in no Case be liable for the Acts or Defaults of such "Risk" committed in more than one Position, nor shall it be liable for any greater Sum than the Amount for which it shall have last been Surety for the "Risk" in the one Office or Position as to which a Claim is made.** — The condition above set forth is in no wise ambiguous and its legal effect is not difficult to explain. In effect it is a valid and effective barrier to cumulative liability arising either through the issuance of renewal policies or by reason of the holding of dual or successive positions by the "risk" during the period of liability. It is to be construed in the light of that other provision of the policy wherein the total amount of liability is limited to the amount named in the policy itself.[2]

The legal effect of such conditions is set forth at some length in the case of Florida Central and Peninsular Railway Company *v.* American Surety Company of New York.[3]

Here the American Surety Company on March 14, 1891, issued to the Florida Central and Peninsular Railway Company a policy of insurance against loss through the defalcation of its employees, among whom was one Thompson, its treasurer. By this policy the railroad company was insured against loss by Thompson's dishonesty or culpable negligence in the sum of $25,000. Before issuing the policy of date March 14, 1891, the surety company had been in the habit of issuing annually

[1] See Buffalo German Ins. Co. *v.* Title Guar. & Tr. Co., 99 N. Y. Sup. 883, and cases cited.

[2] See *ante*, § 116.

[3] 99 Fed. Rep. 674; 41 C. C. A. 45.

to the railroad company a new bond of indemnity, but after that date no new bond was issued. The policy then issued provided, among other things, as follows:

"It is hereby agreed that, subject to the conditions herein contained, the company does hereby insure the employer to the extent of the insurance on each employee against any and all pecuniary loss sustained by the employer of moneys, securities or other personal property in the possession of said employees, or for the possession of which any of them is responsible, by dishonesty or culpable negligence on the part of any of said employees, in the position hereinbefore referred to or the duties in the employer's service which he may hereafter be called upon to perform during the continuance of his insurance under this policy, and which loss shall be discovered during said continuance or within six months after the death, dismissal or retirement of the employee causing such loss, but in no event shall the company be liable for a greater sum than that for which the insurance on the employee is granted, and which insurance and the period thereof are stated in the schedule register hereinbefore mentioned, opposite each employee's name, and the company shall pay to the employer, within sixty days after the receipt of satisfactory proof of the loss under this policy, the amount of such loss, but not exceeding the extent of the insurance on the employee or employees whose dishonesty or culpable negligence occasioned such loss; provided that the company shall not be liable under this bond for the amount of any balance that may be found due the employer from the employee which may have accrued prior to the date of said insurance and which may be discovered within the period of said insurance, it being the true intent and meaning of this bond that the company shall be responsible as aforesaid for moneys, securities and other personal property diverted from the employer within the period specified in said insurance; and it is agreed further, that the company, upon the execution of the stipulated amount of risk of insurance under the terms of this bond in behalf of any employee, shall not thereafter be responsible to the employer under any previous insurance of said employee, it being the mutual understanding that it is the intention of this provision that but one (the last) insurance of an employee shall be in force at one time, unless otherwise provided. The right to make any claim under this policy shall cease at the expiration of six months from the date at which the defaulting employee shall cease to be in the employ of the employer or the date on which the company shall elect to terminate the insurance on such employee, as hereinbefore provided."

Each year the "surety company" furnished to the railroad company a book called a schedule register, and had in its office a copy or abstract of this book in which were entered the names, occupations and locations of the employees for whose conduct security was required and the amount of the indemnity which was agreed to be furnished. At the expiration of each year from and after March 14, 1891, until March 14, 1895, the railroad company made out a new and similar schedule of the employees against whose misconduct they were to be indemnified and the amount of insurance per each, paid the annual premium and forwarded the schedule or copy of it to the security company, which accepted the same and gave notice of its acceptance. The last notice, dated March 18, 1895, which was substantially like the preceding notice, was as follows:

"You are informed that subject to the conditions of the guarantee contract executed March 14, 1891, by the American Surety Company to the Florida Central and Peninsular Railroad Company, the said American Surety Company hereby guarantees the employees of said railroad company as follows, and from the dates herein specified to March 14, 1896."

Thompson continued to be insured until March 15, 1896. The railroad company applied, as usual, in March, 1896, for new insurance, but as the insurance company required an increase of rate no renewal was had.

In July, 1896, the railroad company notified the "surety company" of the discovery of defalcations on the part of Thompson. The latter ceased to be the treasurer for the railroad company on August 1, 1896, and died some two months later. Claims were filed with the "surety company" by the railroad company alleged to have arisen from defalcations by Thompson, occurring at different periods of time between December 15, 1893, and August 1, 1896. None of the defalcations were discovered until three or four months after March 15, 1896. It was contended by the "surety company" at the trial that it was not liable for any of Thompson's misappropriations for

the reason that a large part of the same occurred prior to March 14, 1895, the date of the beginning of the last year of the insurance, and for the further reason that the defalcations of Thompson were not discovered until three or four months after March 14, 1896. The railroad company, on its part, insisted at the trial that the guaranty of Thompson's fidelity was effected by the bond of March 14, 1896, that the contract was a continuing one through the payment of the annual premiums so long as his name remained in the schedule register, and that Thompson's name having remained on that register continuously from March 14, 1891, to August 1, 1896, the indemnity was a continuing one for Thompson during this entire period. The court, in its opinion in this case, said:

"It is evident that it must have been known to the railroad company that the intention of the contract was to make the indemnity of a limited character, and it is also plain that the contract was blindly and clumsily drawn; but so far as it relates to the circumstances of this case we think it is capable of being understood. The bond states no time for its duration and gives the name of no person for whose conduct there is to be indemnity. To make the contract intelligible it must be read in connection with the schedule register and the notice of acceptance, and from them it appears that annually a new list of employees was entered on the schedule which was sent to the surety company and was accepted by it as the list of employees whose fidelity was to be guaranteed from the date of the termination of the preëxisting contract of March 14, for the succeeding year. Some of the names of the preceding list have probably disappeared. New names have taken the place of those who have been dropped, a new annual premium had been paid for those whose names are on the new schedule.

"The course of business between the parties, as well as the policy itself, shows that there is to be an annual designation of the employees on the schedule and an annual selection and acceptance of the names by the 'surety company,' and that the new schedule will in all probability contain the names of employees whose fidelity has been guaranteed by previous contracts. Such being the case, the meaning of the part of the contract which declares that upon the execution of the stipulated amount of risk or insurance in behalf of an employee the company shall not be responsible for any previous insurance for said employee becomes clear, and is that, when the new schedule of the

amount of insurance in behalf of any employee formerly on the schedule has been executed or completed and actually or constructively accepted, the old or previous insurance against losses previously committed by him is at an end, and that for these losses the company is no longer liable. The contract further declares that only the last insurance of the employee shall be in force at one time. These provisions are inconsistent with the theory that it was the intention or idea of the parties that a continuing liability for all undiscovered losses in continuous previous years was being piled up in each renewed contract. The bond also provides that it is its intent that the surety company shall be responsible for property diverted from the employer within the period specified in said insurance. The word 'insurance' has different meanings in the contract. Sometimes it means the amount of indemnity and sometimes it means the contract of insurance. The latter meaning is the one intended in the clause just referred to. For the period specified in the contract of insurance reference must be had to the two other papers which, with the bond, form the contract and which indicate very plainly that the liability was confined to loss in the current year." [1]

While an employee was bonded by a defendant "surety company," he misappropriated money, but discovery thereof was not made until he was under a second bond issued by the same surety company. The bonds each provided that on the "issuance of any bond subsequent thereto, all responsibility thereunder should cease," as it was the intention of the parties that only one bond should be in force at any one time. It was held that while the "surety company" was not liable for the misappropriation under the second bond, it was liable under the first bond; the provision that all *responsibility* should cease not amounting to a provision that all *liability* should cease.[2]

Finally attention is called to the case of Proctor Coal Company *v.* United States Fidelity and Guaranty Company.[3] In this case it appeared that a fidelity bond had been given providing

[1] To the same effect as the foregoing case see U. S. Fid. & Guar. Co. *v.* First Nat. Bank of Dundee, Ill. ; 84 N. E. 370; Am. Bond. Co. *v.* Morrow, 80 Ark. 49; 96 S. W. 613.

[2] Hawley *v.* U. S. Fid. & Guar. Co., 90 N. Y. Sup. 893; 100 App. Div. 12.

[3] 124 Fed. 424.

that the "surety company" issuing the same should not be responsible to the insured under any bond previously issued by it on behalf of the "risk" named in such bond, and that on the issuance of any subsequent bond by the "surety company" all responsibility under the bond in controversy should cease. The bond specifically provided that it was the intention of the parties that but one (the last) bond should be in force at any one time, unless otherwise stipulated. The court held that such provision should be construed merely to prevent a double responsibility on the part of the insurer and that it did not affect the insured's rights under another provision of the first bond authorizing recovery for any defalcation discovered within six months after the termination of the bond.

§ 124. (C) **Conditions providing that if the Insured shall at the Date of the Policy or at any Time thereafter hold any other Policy or other Security against the Loss covered thereby in Addition to such Policy, the Insured shall in the Event of Loss be Liable to pay only such Proportion thereof as the Amount of its Policy bears to the Amount of such other Policy and other Securities taken together.** — Provisions against concurrent or additional insurance are common alike to fire, marine and guaranty insurance; but nowhere do they possess the peculiar features to be met with in the last-named branch of insurance law. For here, in addition to the covenant against liability in excess of the proportionate share in a reduced liability, there are others which become effective whenever the insured holds any other security (insurance or otherwise) to secure him against loss in case of default on the part of the "risk." It will be our purpose, first, to consider briefly the case where the insured holds other insurance only, and then turn to the case where he holds other securities not in the nature of insurance. The other insurance referred to in the above condition means, it would seem, concurrent insurance, outstanding at the time the loss occurred. To be concurrent, the insurance must operate at the same time upon the same

property and look to the indemnity of the insured in case of its loss or destruction from a casualty insured against.

In those cases where the policy does provide that the holding of other insurance at the date of the policy or at any time (whether at the time of loss or otherwise) shall have the effect of reducing proportionately the insurer's liability in case of loss, it is perhaps doubtful whether such a provision would under all circumstances be literally enforced by the courts; as, for example, where the insured has made no representation as to the existence of other insurance as a basis or an inducement for the issuance of a second policy and a loss is incurred that exceeds in amount in the aggregate the face of all outstanding policies. One of the few cases of strict fidelity insurance where this question has come up for judicial construction is that of Ætna Insurance Company *v.* American Surety Company.[1] Here a general agent of a life insurance company had on April 1, 1884, delivered to it a policy issued by a "surety company" for the faithful performance of his duties so long as he should have continued in that office. On June 15, 1884, he procured and handed over another policy of similar purport for one year, which the insured accepted with the understanding that liability thereunder was limited to defalcations committed during that time. The old policy, however, was retained. One provision of the new policy was to the effect that if the insured should hold concurrently with it any other bond, the loss, if any, should be apportioned. It was held that as to any loss resulting between June 15, 1884, and June 15, 1885, the two policies were not concurrent, and that the last policy could be proceeded against for the whole.[2]

Turning now to the case where the insured holds "other security" not of the character of insurance, it is probable that in all cases where such security is outstanding and available to the insured at the time a loss occurs, the condition will be given full force and effect by the courts. However, it is by no

[1] 34 Fed. 291.

[2] See also Am. Cr. Indemn. Co. *v.* Wood, 73 Fed. 81; 19 C. C. A. 264.]

means clear just what may properly be included under the phrase, "other security." Is it broad enough to include that class of securities from the sale of which moneys might be realized for the reimbursement of the insured? Doubtless this is so, and the amount of reduction to which the insurer would be entitled, under such a condition, might in this way always be ascertained. In case the insured simply held a private surety bond, this would doubtless have to be sued on and an execution issued before the amount of deduction to which the insurer was entitled could be definitely ascertained. Again, it should be observed that the right of subrogation secured to the insurer by an express provision in the policy to that effect may have an important bearing on the construction to be given by the courts to the condition now under discussion. This holding of other security by the insured has many points of resemblance to the case of a creditor, in ordinary private suretyship, who takes new and additional security. Here the benefit of such additional security could only be available to the surety as a matter of legal right, after he had paid the debt; while under the conditions above set forth it would, if the same were held valid, be available to a proportionate extent at once.[1]

Where a policy of fidelity insurance contains a provision to the effect that, if the insured took out other insurance, he should immediately report the same to the insurer, it is safe to say that the obligation not to take further insurance without notice would not be construed as imposing a forfeiture.[2]

Where there are two sets of insurers as to the same liability, the question as to which set is liable is said to be largely a question of fact.[3]

An interesting and closely related question to the one now under consideration is touched upon in National Surety Company *v.* United States.[4] Here a surety company had executed a bond as surety for the performance of a certain mail route

[1] See, however, *post*, § 123.

[2] F. & C. Co. *v.* Carter, 57 S. W. 315; see also Union Cas. & Sur. Co. *v.* Bailey, 61 Pac. Rep. 452.

[3] Lincoln Tr. Co. *v.* Tracey, 77 Mo. App. 96.

[4] 123 Fed. 294.

contract. The court held that it was no defence to an action thereon, that the government (the insured) had taken a proposal bond covering the same liability prior to the execution of the bond in suit, and that an action brought to enforce the same had been voluntarily dismissed. It was further held that where the United States took a proposal bond securing the performance of a mail route contract, and later letting the contract, required another bond from another contractor (which obligation was an independent undertaking), the second obligation did not stand as a guaranty for the performance of the first. On this point the court in its opinion spoke as follows:

"Briefly stated, the principal question raised by the assignments of error is whether in an action against the surety to enforce the contract made by his principal with the government, it is a defence that previous to the time when the surety entered into his obligation, the government had taken the application of another surety for the performance by the principal of the same contract. We are aware of no rules of law that require a creditor who has the obligation of two different sureties for the performance of one and the same contract by the principal to enforce one or the other. They are concurrent securities for the same debt or judgment, and the creditor has the option to proceed to the enforcement of either at his election."

When there are different bonds given by a bank official covering different periods of time with different sureties, an unappropriated payment made by the common principal is not to be always applied by the court to the oldest obligation. Regard must be had to the responsibility of the different sureties, as limited by the period for which they respectively contract, as well as to the injustice that would ensue if collections received under one obligation are applied to the discharge of a liability under a preceding or succeeding term with distinct sureties.[1]

§ 125. **General Rules Determinative of the Extent of the Insurer's Liability under the Conditions of the Policy.** — It is somewhat difficult to gather from a cursory reading of a policy

[1] First Nat. Bank of Nashville *v.* Nat. Sur. Co., 130 Fed. 407.

the conditions therein which directly determine the amount of the insurer's liability thereunder after a loss has been incurred by the insured through the acts of fraud or dishonesty on the part of the "risk."

In general these conditions may be outlined as follows:

(A) That the basis of the loss for which the insurer shall be held liable shall be limited to moneys, securities and other personal property in the lawful possession of the "risk" either belonging to the insured, or for the possession of which he is legally responsible.

(B) The contract as between the insurer and the insured is one of indemnity and thereby may give rise under certain circumstances to the right of set-off in favor of the insurer as against the insured, as well as necessitate the payment of interest by the former to the latter after the time provided for in the policy within which claims must be paid has expired.

(C) The liability of the insurer, if admitted to be within the scope of liability named in the policy, is an absolute one, and the right of enforcement thereof by the insured does not depend upon the latter's first making use of securities held by it as security for possible loss through acts of the "risk."

§ 126. (A) **That the Basis of the Loss for which the Insurer shall be held liable shall be limited to Moneys, Securities and other Personal Property in the Lawful Possession of the "Risk" either belonging to the Insurer, or for the Possession of which he is legally responsible.** — To attain the result aimed at by the foregoing, there is sometimes inserted in the policy a clause reading substantially as follows:

> "The insured shall make and reimburse to the insured, to the extent of — dollars, all and any pecuniary loss sustained by the insured through fraudulent or dishonest acts of the 'risk with respect to moneys, securities or other personal property in the lawful possession of such 'risk' belonging to the insurer, or for the possession of which he is legally responsible."

The provision here set forth is doubtless inserted for the

purpose of showing the nature of the insurable interest of the insured in the policy, as well as to assist in case of loss, in determining the extent of the insurer's liability under the policy. In other words, unless the insured has an insurable interest in the property at the time the loss occurs, he cannot recover therefor on the policy.[1] In a recent federal case, this direct question was before the court for determination in connection with an attempted enforcement of liability on a fidelity bond. In that case the trial court submitted to the jury the question, whether on all the testimony, Fesner (the "risk") was to be regarded as the lessee of the restaurant company (the insured) or merely their manager, stating that if they should find that he was the lessee, their verdict should be for the defendant, because the moneys he received he would in that case have received in his own right, owing to the restaurant company only a stipulated rent, and an appropriation of money under such a state of facts would not come within the assumption of want of honesty by such "risk." If, however, the jury should find that Fesner was the manager and not the lessee of the restaurant company, then the question was submitted to the jury, whether the said restaurant company had discovered any fraudulent or dishonest acts on the part of Fesner prior to the certificate of December 23, 1899, or had neglected to avail itself of opportunities to discover whether such fraudulent or dishonest acts had been committed.[2]

§ 127. (B) **The Contract between the Insurer and the Insured is one of Indemnity, and thereby may give rise under certain Circumstances to the Right of Set-off in Favor of the Insurer as against the Insured, as well as necessitate the Payment of Interest by the Former to the Latter after the Time provided for in the Policy within which Claims must be paid has expired.** — Whether the policy makes provision for it or not, the insured has probably the right to deduct, in settlement of claims, any moneys due the "risk" from the insured by way

[1] See *ante*, § 30.

[2] Carstairs, *et al.* *v.* Am. Bond. & Tr. Co., 116 Fed. 449; C. C. A. 3d Cir.

of salary in the identical employment in which the policy was furnished. Likewise by an insertion of such a provision in the policy, the right to retain any unearned portion of the current premium after payment of loss is secured. In Liverpool Starr Bowkett Building Society *v.* The Travellers' Insurance Society,[1] it was held that amounts credited to the employee should be deducted from the £150 embezzled, and not from the £100, the amount of the policy. Also that the £100 must be paid first and that the insured must hold what was found to be due the "risk" from the society for the insurer in reduction of the £100 liability of the latter to the insured. The question sometimes arises as to whether, in settlement of claims, the insurer has the right, if he chooses so to do, to set off any valid claims that may exist in favor of the "risk" against the insured, to reduce the latter's claim against it. In cases of gratuitous suretyship the right seems to clearly exist. As to whether it exists in fidelity insurance is at least a matter of some doubt. However, a broad interpretation of the insurer's right of subrogation ought to include the right here referred to.

Thus if at the time a loss occurs there is any salary due the "risk" from the insured, immediately upon payment of loss the insurer would be entitled to the same or could in settlement of loss with the insured set off such salary as against the loss *pro tanto*.

The mere fact that after a loss has occurred under a policy, the insured recovered from the "risk" a part of its moneys stolen exceeding in amount the insurer's liability under the policy, does not relieve the insurer from liability thereunder so long as the total loss exceeded the sum insured. Neither does the fact that after loss has been incurred the insured communicates with the absconding "risk," relieve the insurer from liability.[2]

[1] 9 Times L. R.

[2] London Guar. Co. *v.* Hochelaga Bank, Quebec L. R. 3 Q. B. 25. See generally Buffalo German Ins. Co. *v.* Title Guar. & Tr. Co., 99 N. Y. Sup. 883.

§ 128. (C) **The Liability of the Insurer, if admitted to be within the Scope of Liability named in the Policy, is an absolute one, and the Right of Enforcement thereof by the Insured does not depend upon the Latter's first making Use of Securities held by it as Security for possible Loss through Acts of the "Risk."** — It is an obvious truth in fidelity insurance law that the act of making indemnity by the insurer to the insured necessarily has reference to certain preliminary acts on the part of the insured which are conditions precedent to the payment of loss by the insurer. In a certain sense the liability of the insurer to the insured is secondary to that of the "risk" to the insured, and therefore arises only after default on the part of the latter. But when this has been said, it does not follow that in respect to the right of enforcement the obligation of the insurer under the policy is in any respect dependent upon the exhausting of any remedies on the part of the insured that he may have as against the "risk." This question was conclusively settled in American Surety Company *v.* Lawrenceville Cement Company.[1] Here it was claimed that the insurer was entitled to require the insured to exhaust the property of the "risk" before enforcing the obligation of the policy, and it was further claimed that before paying the insured the amount due it on its policy the insurer could require the insured to wait collection of indemnity by the insurer from the "risk." Both these claims of right were denied absolutely, and the right to demand indemnity forthwith after the occurrence of the loss was sustained.[2]

Again even if the fact were conceded that a third party is liable for a loss resulting to the insured from the fraudulent act of the "risk" (in raising the amount of checks issued by the insured), nevertheless the existence of such liability would not release the insurer issuing a fiduciary bond from liability thereon to plaintiff.[3]

[1] 96 Fed. 25; 110 Fed. 717.

[2] See also in this connection Am. Bond. & Tr. Co. *v.* L. & W. V. Gas. Co., 95 Fed. 49.

[3] Champion Ice & Cold Storage Co. *v.* Am. Bond. & Tr. Co., 115 Ky. Ct. of App. 863; 75 S. W. 197.

§ 129. **When Losses become payable.** — The policy usually provides that within a certain time next after the notice, accompanied by satisfactory proof of a loss, has been given to the insurer, the latter shall make good and reimburse to the insured all and any pecuniary loss sustained by the latter through acts of the "risk" as specified in the policy. It is true that the time for voluntary payment of claims so designated can only run after notice and proof of loss of the character specified as "satisfactory." [1] So, too, the insured is not entitled to interest on its claim during the running of this period.

In the case of Guaranty Company of North America *v.* Mechanics Savings Bank and Trust Company,[2] it was held that under guaranty insurance policies, interest should be allowed independent of statute, from the date of embezzlement or from the end of each year to the filing of the proofs of loss; but on this amount there can be no interest after that time where, by the terms of the policy, a loss is not due until three months after filing proof of loss. "Neither do we see," observed the court,

"any objection to the interest allowed. It is urged that it does not appear that the bank could have made six per cent on the lost money if it had not been stolen, since it did not discover the thefts until 1893, and that the only basis for adding interest is to make good the loss of the use of the money in the meantime. This is a mistaken view of the law of interest. The Tennessee code allows interest on bonds.[3] If a policy of insurance be not included in this statutory allowance when it takes the form of a bond, as this does, it may be allowed by the jury or the chancellor as 'damages' for money detained. Here the defendant company agreed to make good the loss sustained by the fraudulent acts of the 'risk,' and if the latter had been sued, the jury or chancellor could have allowed interest against him as part of the damages or 'loss,' and this the defendant company assured. Interest should be allowed from the date of embezzlements, or from the end of each year, if the jury or

[1] See Am. Sur. Co. *v.* Pauly, dissenting opinion of Justice White, 170 U. S. 179; City Tr., Safe Dep. & Sur. Co. *v.* F. & C. Co. of N. Y., 58 N. Y. Sup. Div. 18.

[2] 80 Fed. 766; 26 C. C. A. 146.

[3] Mill & V. Code Ten. for 2702.

the chancellor choose, as he did here, to the filing of the proof of loss, up to the penalty of the bond but not beyond it, of course. Then on this amount there could be no interest for three months, since that sum is not due by the terms of the contract until three months after filing proof of loss. But if not then paid, it bears interest as a debt due from that date if allowed by the jury or chancellor, when not given by a statute. We think it should be allowed in this case, whether given by statute or not. Being allowed, it should be calculated to the date of the decree, as in other cases." [1]

CHAPTER XIII

DISCHARGE OF THE INSURER'S LIABILITY BY RELEASE THEREOF THROUGH ACTS OF THE INSURED

§ 130. (VIII) **Discharge of the Insurer's Liability by Release thereof on the Part of the Insured.** — As has already been observed in preceding sections of this work, the policy issued by the insurer to the insured always presupposes and has reference to the existence of a collateral contract subsisting between the insured and the "risk." As fidelity insurance is a contract of indemnity pure and simple, it would cease to be such if there could at any time be said to exist a liability under the policy on the part of the insurer to the insured, when there was not in existence at the same time a coexisting liability on the part of the "risk" to the insured.[2]

Therefore, it is proper to apply in this connection a well-established principle of law that whenever the principal thing is discharged (here the obligation of the "risk" to the insured), the incidents thereto (in this connection the liability of the insurer to the insured) are discharged.

With respect to liability, the contract of the "risk" with the insured existing contemporaneously with the contract of insurance entered into between the insurer and the insured,

[1] As to necessity of demand before suit against the surety, see Heinemann *v.* Brasch, 53 N. Y. Misc. 552; 103 N. Y. Sup. 720.

[2] See *ante*, § 30.

must furnish the necessary insurable interest to support the policy of fidelity insurance.[1] For the foregoing reasons the effect of any release, either absolute or partial on the part of the insured, whereby the liability of the "risk" to such insured is extinguished, may have the effect in law of releasing *pro tanto* the liability of the insurer to the insured under the policy. However, the effect is not necessarily such as has here been stated, for it is rare indeed when the policy issued by the insurer covers every liability or claim which may accrue in favor of the insured against the "risk." For this reason to operate as a release of the insurer's liability to any extent, the act of the insured in releasing the "risk" must relate to some liability of the latter which is covered by the policy.[2] The release of liability which will here be considered has reference, not to acts of the insured which by operation of law have the effect under the wording of the policy of releasing the insurer's liability to the insured, but reference is had to a direct and intentional release of the "risk's" liability by the insured. Such a release may be brought about in one of the three following ways:

(A) By a formal release of liability either absolute or partial, running from the insured to the insurer.

(B) By a formal release of the "risk's" liability to the insured, running from the insured to such "risk."

(C) By a release of securities held by the insured and procured by it either through the "risk" or a third party, given for the purpose of indemnifying the insured against loss occurring through acts of unfaithfulness on the part of the "risk" while in the insured's employ.

§ 131. (A) **Formal Release of the Insurer's Liability by the Insured.** — Inasmuch as the right of enforcing liability under the policy exists solely in favor of the insured, it follows as a matter of course that such liability may always be discharged

[1] See Monongahela Coal Co. *v.* Fid. & Dep. Co. of Md., 94 Fed. 732; 36 C. C. A. 444.

[2] See Bank of Tarboro *v.* Fid. & Dep. Co., 126 N. C. 320; 35 S. E. 588; 38 S. E. 908.

by formal release thereof running from the insured to the insurer. This release of liability may be either total or partial and the granting of such release has no effect whatever upon the liability of the "risk" to the insured.

§ 132. (B) **Discharge of Insurer's Liability by Formal Release of the "Risk's" Liability running from the Insured to such "Risk."** — Fidelity insurance is preëminently a contract of indemnity. Therefore there can be no legal liability incurred by the insurer under a policy of fidelity insurance, unless there exists at the same time a liability at least as coextensive on the part of the "risk" to the insured. Furthermore it follows that when there is a voluntary release on the part of the insured of the "risk's" liability to it, such release has the effect in law of releasing the insurer from liability — if such exists — to the insured on account of the matter covered by the release of the "risk" by the insured. A similar result is arrived at whenever the liability of the "risk" to the insured is satisfied by payment of the debt represented by such liability. In other words the principal obligation — that of the "risk" to the insured — being satisfied, the incidental obligation — that of the insurer to the insured — is likewise discharged.[1]

It is doubtless true that even where the insured secretly receives from the "risk" the full amount of the insurer's liability on account of a loss covered by the policy, he will be held in law, under a well-recognized rule of subrogation, to hold such payment in trust for the insurer, as the law will not permit him to profit by a recovery for the same debt against both the insurer and the "risk." [2]

In Boush *v.* Fidelity and Deposit Company of Maryland,[3] the court held that:

"There was evidence tending to show that the defendant, before the institution of the prosecution against the plaintiff, knew of the exist-

[1] Perpetual Bldg. & Loan Ass. *v.* U. S. Fid. & Guar. Co., 118 Ia. 729; 92 N. W. 686.

[2] See in this connection Am. Sur. Co. *v.* Lawrenceville Cem. Co., 110 Fed. 717; C., St. L. & N. O. Ry. Co. *v.* Pullman Sou. Car Co., 139 U. S. 79.

[3] 100 Va. 735; 42 S. E. 877.

ence of a convention between the insured and the 'risk,' by which the relations between them in respect to the premiums alleged to have been embezzled were changed from those of principal and agent to creditor and debtor. That circumstance, the court held (in an action for malicious prosecution), had an important bearing upon the question of probable cause and ought not to have been excluded from the instruction (with the evidence tending to establish it) for the consideration of the jury."

§ 133. (C) **The Discharge of Liability by Release of Securities held by the Insured as Indemnity against Loss through Acts of the "Risk."** — It may be stated that if the insured obtains control of money or property of the "risk" to which it is not otherwise entitled and which he may lawfully apply to the discharge of an existing obligation of the "risk" to him, and thereafter, without the consent of the insurer, voluntarily surrenders or releases such securities, so that the insurer loses the benefit of the same, the latter is discharged from liability under the policy to the extent of the value of the securities thus surrendered. On the other hand, where the insurer holds security or counter-indemnity given by the "risk" to it, so long as it (the insurer) remains solvent, it does not have to obtain the insured's consent to release it.[1]

Under the Civil Code of Montana[2] it is provided that creditors shall be entitled to the benefit of securities given to a surety as indemnity. The foregoing provision was held[3] to apply only to cases where the indemnity was furnished by the "risk." Thus where a money judgment was rendered against such debtor, and a stranger to the action deposited securities in a bank to indemnify the surety on an appeal bond, the securities so deposited could not be applied to the payment of the creditor's claims. Evidence is always admissible in an action for the recovery of securities so deposited to show by whom it was made.

[1] See Am. Sur. Co. *v.* Lawrenceville Cem. Co., 110 Fed. 717; Fertig, *et al. v.* Henne, 47 Atl. Rep. 840; Pa. ; Bubb *v.* A. B. & F. Co., 30 Pitts. Legal Journ. 361.

[2] § 3700.

[3] O'Neil *v.* City Sav. Bank, *et al.*, Gardner, *et al.*, intervenors, 34 Mont. 521; 87 Pac. 970.

As soon as the period of liability under the bond is terminated and the period for filing claims thereunder has expired, the "risk" is entitled to the return of all securities deposited by him with the insurer to indemnify the latter upon a fidelity bond furnished by it to the insured.[1]

[1] Shea *v.* F. & C. Co., 83 App. Div. 305; 82 N. Y. Sup. 39.

PART III. — OFFICIAL BONDS

CHAPTER XIV

ATTACHMENT, DURATION AND SCOPE OF LIABILITY UNDER OFFICIAL BONDS

§ 134. **Official Fidelity Bonds — defined and discussed.** — An official fidelity bond in the only proper sense in which the term is used is one taken in pursuance of a public statute. Within the term is to be found a form of guaranty insurance, whereby, for a valuable consideration, one party, termed the "insurer," agrees to indemnify another, termed the "insured," in a designated amount against loss arising from the fraud, dishonesty, unfaithfulness, negligence or inability to produce property entrusted to his care, of a third party, termed the "risk," holding a public office, for the benefit of the insured.[1]

The office held by the "risk" in the foregoing definition has reference to a public situation or employment conferred by election or appointment. The term embraces the ideas of tenure, duration, emoluments and duties.

An official fidelity bond does not arise solely out of contract, but is an incident to an appointment or election from governmental sources.[2] There existed no requirement at common law which compelled public officials to give a bond for the faithful performance of their official duties. Such a requirement, if it exists at all, must be found in the statutes. Public officials, like any other individuals, are liable to the parties

[1] Faurote *v.* State, 110 Ind. 463; 11 N. E. 474; Anderson *v.* Thompson, 73 Ky. 136; State *v.* Nevin, 19 Nev. 162; 7 Pac. 651.

[2] Henley *v.* Mayor of Lynne, 5 Bing. 91; Rollin *v.* Mayor, 83 N. Y. 372.

sustaining loss through their official acts, whether a bond has been given or not.[1] It has been said that there are three parties in effect to official fidelity bonds, to wit: the insurer, the insured (a public or quasi-public corporation) and the "risk."[2]

Among the elements which distinguish bonds covering public officials from those given for the benefit of persons holding private employment may be mentioned the following: That "surety companies" furnishing such official bonds cannot, as a general rule, claim as against the state the benefit of any violation of statutory provisions on the part of the insured. This for the reason that such statutory provisions are presumed as a matter of law to be enacted for the benefit of the state, and not of the "surety companies."

Again, it will appear that statutory official bonds, while they may be void as statutory bonds because of their failing in some particular to comply with the condition of the statutes in such case made and provided, may yet be held valid as common law bonds. As a general rule, as against the state, the "surety companies" will not be permitted to avail themselves of any alteration of contract had between the "risk" and the insured, without the knowledge or consent of the surety company.

Again, in order to sustain the validity of an official bond, the courts make a wide application of the doctrine of *de facto* as distinguished from *de jure* officers.

§ 135. **Nature of Official Fidelity Bonds.** — The Supreme Court of Georgia in the case of Mayor, etc. of Brunswick *v.* Harvey, *et al.*[3] specifically held that bonds furnished by a compensated surety, covering defaults by public officials, are in the nature of policies of fidelity insurance. That such is their character is now established beyond question.[4]

[1] Cole *v.* Dallneyer, 101 Mo. 37; 13 S. W. 687.

[2] Bryant *v.* Am. Bond. Co., 76 Ohio 253; 82 N. E. 960.

[3] 114 Ga. 733; 40 S. E. 754.

[4] See *ante*, § 3; see also to the same effect Mayor, etc. of Brunswick *v.* Harvey, *et al.*, 114 Ga. 733; 40 S. E. 754, and cases cited.

§ 136. **Construction of Official Fidelity Bonds.** — A cardinal principle of construction in connection with official fidelity bonds is that all statutory provisions relative thereto necessarily enter into and become a part of the bond, the same as if written therein in the first instance.[1]

In this branch of the general subject of guaranty insurance, one is here brought face to face as elsewhere with the question as to whether "surety companies," when sued on an official fidelity bond issued by them, are entitled to claim that their obligation is *strictissimi juris*. The rule applicable to similar contracts entered into by gratuitous sureties is well set forth by the Supreme Court of Georgia[2] as follows:

"The contract of sureties upon an official bond is subject only to the strictest interpretation. They undertake nothing except what is within the letter of their contract. The obligation is *strictissimi juris*. Nothing is to be taken by construction as against the obligor. They have consented to be bound to a certain extent only, and their liability must be within the terms of that consent."

The foregoing is the rule that had well-nigh the universal support of the courts prior to the advent of the compensated surety. It now remains for us to ascertain whether that rule has been changed by recognition on the part of the courts, that the fact that the surety receives compensation for entering into his obligation is sufficient in itself to alter the rule that was so long applied in the case of gratuitous sureties. As representing the utterance of a court of high authority upon this question attention is called to that of the United States Circuit Court of Appeals (8th Circuit), rendered in the case of National Surety Company *v.* United States,[3] in which the court spoke as follows:

"The agreement of the surety must be strictly construed. His responsibility may not be extended by implication beyond the terms

[1] U. S. Fid. & Guar. Co. *v.* McLaughlin, *et al.*, Neb. ; 107 N. W. 577; U. S. Fid. & Guar. Co. *v.* U. S. Tr. & Sav. Co., 142 Ala. 532; 38 Sou. 177; see also State to the Use of, etc. *v.* John E. Hill & Fid. & Dep. Co., 88 Md. 111; 41 Atl. 31.

[2] Mason *v.* Commissioners, 104 Ga. 34; 35 S. E. 513.

[3] 129 Fed. 70.

of his bond. An additional liability, which his bond does not clearly show to have been within the reasonable contemplation and intention of the parties to it when it was made, cannot be imposed upon him by the subsequent action of the obligee or of the principal in the bond.

"But the contract of the surety, like all other contracts, must have a reasonable construction. An interpretation which, while it carefully restricts his responsibility to which he agreed to undertake, does not fail to hold him to that liability which by the plain terms of the agreement he contracted to assume." [1]

But the true rule applicable to the construction of official bonds has been enunciated by the Ohio Supreme Court.

In Bryant *v.* American Bonding Company [2] that court asked and answered the query as to "What is the proper rule of construction to be applied to official bonds," as follows:

"First, What is the nature of the contract? Is it one of suretyship and one of those known as voluntary contracts, or is it rather one of the class issued for money consideration and because of a desire for pecuniary gain? If the former, then it is one wherein the surety is regarded as a favorite of the law, and all doubtful questions can be resolved in his favor. If the latter, then it is regarded as an insurer whose contract being drawn by the surety itself and for a money consideration, and if ambiguity exists in the language of the contract, the same must be resolved most strongly against the surety.

"It is not necessary in this case to carry the rule respecting insurance contracts so far as it has been held in many reported cases. It is sufficient to apply to the contract the modified rule clearly recognized in this state, viz.: that where clauses of such a contract are supportable of two interpretations, which seem equally fair, that would be preferred which is less favorable to the company, but like other contracts they should receive a reasonable construction in order to carry out the true intention of the parties as expressed by the language used."

In all cases where official bonds are before the courts for interpretation the same must be given a reasonable construction. Justice to both the insurer and the insured requires an interpretation which, while it carefully restricts the respon-

[1] See to the same effect Sparks *v.* Board of Commissioners of Cherokee Co., Kan. ; 91 Pac. 89.

[2] 76 Ohio 253; 82 N. E. 960.

sibility of the insurer to that which it agreed to undertake, yet does not fail to hold it to that liability which, by the plain terms of the bond, it contracted to assume.[1] An official bond, after all, is nothing but a contract and like the general run of contracts should be given a just and rational interpretation. The purpose of every written contract is to express the intention of the parties. The object of all construction of agreements is to ascertain that intention to the end that it may be enforced. The court should, as far as possible, put itself in the place of the parties, with their minds upon the terms of the agreement, and then, from a consideration of the writing itself, its purposes and the circumstances which surround its making, endeavor to ascertain what the parties intended to agree to do. That intention must be deduced, not from any specific provision or fragmentary parts of the bond, but from the entire instrument, because the intent is not bound by any part or provision of it, but by every part and term thereof, so construed as to be consistent with every other part and with the entire contract. The actual intent of the parties when thus ascertained should always prevail over inapt expressions and careless recitals in the bond, unless that intention is directly contrary to the plain meaning of the binding words of the agreement. That construction which sustains and vitalizes an agreement should be preferred to that which strikes down and overrides it. Such a construction should be placed upon the bond as will give effect to the obligation of each of the parties thereto.[2]

§ 137. **Necessity of Insurable Interest in Official Fidelity Insurance.** — The same necessity for the possession of an insurable interest on the part of the insured in order to sustain the validity of the contract exists in the case of official fidelity bonds as in private fidelity insurance. Without the possession

[1] U. S. Sur. Co. *v.* U. S., 129 Fed. 70.

[2] U. S. Fid. & Guar. Co. *v.* Board of Commissioners of Woodson County, 145 Fed. 144; Rogers *v.* U. S., 32 Fed. 890; Alexandria *v.* Corse, 2 Cranch, C. C. 363; B. & O. R. R. Co. *v.* Jackson, 1 Pa. Cases 332; 3 Atl. 100.

of such insurable interest the insured cannot recover from the insurer any loss occurring during the life of the bond.[1]

§ 138. **Execution of Official Fidelity Bonds.** — With respect to the execution of official fidelity bonds, exactly the same principles are applicable as in the case of private fidelity insurance bonds.[2]

§ 139. **Voluntary Official Fidelity Bonds.** — In a recent Georgia case[3] a surety company furnished a bond to a municipality, guaranteeing the latter against the fraud and dishonesty of the city treasurer. No statute existed requiring the furnishing of such a bond. For this reason, the court held that the obligation thus given was not statutory but a voluntary bond, and that therefore, where the "risk" in such a bond agrees merely to enter into an obligation to save the municipality harmless and makes no specific promises or covenants to it, the surety is not liable on such a bond. In making this holding the court spoke as follows:

"Instead of giving the bond required by the treasurer, Harvey gave one signed by the Fidelity and Guaranty Company, which was in the nature of a policy of fidelity insurance, insuring the city against his fraud and dishonesty. While his name was signed to this bond, he, as before recited, made no promise or covenant to the city, but merely undertook to save the city harmless. A careful examination of the bond will show that it is not in the nature of a statutory bond at all, but is in its nature a policy of fidelity insurance. The company agreed with the city to pay any loss the latter might sustain by reason of Harvey's fraud or dishonesty, and the application is hedged about with many conditions and limitations. Not being a statutory bond, this obligation must be dealt with as a common law bond. Being a bond of this nature, it makes the company liable under its provisions only; and the above cited section of the code cannot possibly be applied to said bond, even if it could ever be applied to the bond of officers of municipal corporations."

[1] See *ante*, § 30; Cushing *v.* Lickett, *et al.*, Neb. ; 112 N. W. 616; United States *v.* U. S. Fid. & Guar. Co., 150 Fed. 550; Connolly *v.* Am. Bond. & Tr. Co., 113 Ky. Ct. of App. 903; 69 S. W. 959.

[2] See *ante*, § 33.

[3] Mayor, etc. of Brunswick *v.* Harvey, *et al.*, 114 Ga. 733; 40 S. E. 754.

The Rhode Island Supreme Court [1] held that where a tax collector of a school district is not required by statute to give a bond, with a surety company as surety nor authorized directly or indirectly to incur expense for such a bond, that he cannot recover from the district the amount paid for the premium on such bond.

§ 140. **Attachment of Liability under Official Fidelity Bonds.** — Not infrequently in the case of insurance policies issued upon persons holding positions of public trust, attempts are made to avoid liability by claiming that the same has not attached under the policy; on such grounds, for example, as alleged lack of consideration, or by claiming that the "risk" was never in fact duly appointed or elected to the office wherein the policy was required by law to be given.

As a general rule the insurer will be held to be estopped from alleging want of consideration as a defence to an action to enforce its liability on an official bond.[2] In this connection it should be noted that one of the considerations necessary to support the contract is the annual premium usually covenanted to be paid by the "risk" to the insurer. However, where the bond is entered into for the benefit of the state, the contract may be sustained, irrespective of any monetary consideration upon the principle of a contract made for the state's benefit, which it has accepted. The element of consideration may also be worked out upon the theory that the state furnished a valid consideration for the giving of the bond by granting public employment to the "risk." [3]

Again, on this subject the Alabama Supreme Court in Fidelity and Deposit Company *v.* Mobile County [4] observed that little is necessary to be said in disposition of the alleged want of consideration for the execution of the bond by Lott,

[1] Wood *v.* School Dis. No. 5, R. I. ; 67 Atl. 65.

[2] Nat. Sur. Co. *v.* Di Marsisco, 105 N. Y. Sup. 272; 55 Misc. 302.

[3] See Bryant *v.* Am. Bond. & Tr. Co., 76 Ohio 253; 82 N. E. 960; Fid. & Dep. Co. *v.* Libby, 72 Neb. 850; 101 N. W. 994.

[4] 27 Sou. 386.

the "risk," and the defendant (the insurer). The recitals of the instrument itself cut off the defendant from showing that it is lacking in consideration. The bond was given by Lott in compliance with the requirement of the judge of probate, professing to be predicated on an address of the grand jury for the execution of an additional bond by Lott as tax collector. The record address of the grand jury required an additional bond, and the bond was given upon that requirement, and under it Lott continued in the office of tax collector, as without it he would have been immediately ousted. On this state of the case the defendant is estopped to say that the address of the grand jury had spent itself and become ineffective before the requisition was made; that, therefore, the requisition was of no efficacy, there being no grand jury address to support it; that there was no legal occasion for the execution of the additional bond, and in consequence the bond which was given was without a consideration and void. "From all this," the court said, "the insurer has precluded itself by the recitals of the instrument it executed."

The principle to be deduced from the foregoing is that the insurer may estop itself by means of apt recitals in its policy from contending that liability thereunder has not attached.[1]

In order that the policy should relate back, the language of the policy must be retrospective and employ terms that relate to the past rather than to the future.[2]

§ 141. **Attachment of Liability where Official Fidelity Bond is required to be approved as a Condition precedent to the Creation of Liability thereunder.** — It not infrequently happens that the statute requiring the furnishing of an official fidelity bond by a public officer likewise requires the approval of such a bond by a designated official or official body as a

[1] See Walker County *v.* Fid. & Dep. Co., 107 Fed. 851.

[2] City of Grand Haven *v.* U. S. F. & C. Co., 128 Mich. 106; 87 N. W. 104; see also *post*, § 142.

condition precedent to the right to assume the duties of the office. Where such statutes exist, they are probably to be regarded more in the light of a protection to the public rather than as a condition precedent to the attachment of liability on the part of the compensated surety. In short, such conditions can undoubtedly be waived by the insured, and such bonds may be enforced against the "surety company" by the application of the doctrine of estoppel.[1]

In a recent case [2] it appeared that the statute required that the bond of a tax collector should be executed in duplicate and approved by a judge of the probate court and that one of such duplicates should be filed in the office of the judge of probate and the other in the office of the auditor of the state. The court held that the statute did not authorize the auditor to reject or refuse to accept a bond approved by the judge of probate and hence the fact that the auditor refused to accept such a bond constituted no valid defence to an action against the surety company issuing the same.

§ 142. **Attachment of Liability by Application of the Doctrine of Estoppel.** — As a general rule it may be asserted that want of consideration is no defence to an action brought to enforce the liability of a compensated surety on an official fidelity bond issued by it for the benefit of the public.[3]

It may be stated as a general principle in this connection that where a bond is given by a public official and is required by statute, and such official is permitted to assume the performance of the duties of his office on the strength of the furnishing of such a bond, in such case the surety furnishing the bond is estopped to set up in an action to enforce its liability thereunder such defences as want of consideration, lack of approval by proper authority, etc.[4]

§ 143. **Attachment of Liability where the "Risk" is a *De Facto* and not a *De Jure* Official.** — The Kentucky court of

[1] See *post*, § 144.

[2] Bromberg *v.* Fid. & Dep. Co. of Md., 139 Ala. 529; 36 Sou. 622.

[3] Nat. Sur. Co. *v.* Di Marsisco, 105 N. Y. Sup. 272; 55 N. Y. Misc. Rep. 302.

[4] Bromberg *v.* Fid. & Dep. Co., 139 Ala. 529; 36 Sou. 622.

appeals,[1] commenting on the question as to whether an official fidelity bond covers acts of a *de facto* as well as a *de jure* official, spoke as follows:

"The failure of a person duly elected or appointed to an office to take the prescribed oath or give a bond as required, or either, does not, when he has proceeded to exercise the functions of the office, invalidate his acts so far as the public or a third person are concerned. As to them his acts are valid as though he were the officer *de jure*. His title to the office cannot be attacked collaterally, but only by direct proceedings in the nature of *quo warranto*. The failure to qualify constitutes a ground for ousting him from the office. Certainly this rule should be applied as against the 'risk' himself, and his surety on the bond as the collector cannot collaterally raise the objection that he had not given a bond as assessor as a defence, so far as he actually collected the taxes."[2]

§ 144. **Attachment of Liability when Statute is not strictly complied with.** — An important question is presented in the case of bonds covering the defaults of public officers when the form or subject-matter of the official bond does not conform to the provisions of the statute regulating the same. This question was gone into at some length by the Maryland Supreme Court in State to the Use of, etc. *v.* John E. Hill and Fidelity and Deposit Company.[3] The "risk" in this case was secretary and treasurer of a board of county commissioners. The policy issued upon him simply provided that he should faithfully pay over and apply all moneys that should come into his hands as treasurer to such persons and in such manner as the said board shall direct. This was in the words of the Maryland statute, except that the statute provided for payment "to such persons and in such manner as said board may, *under the provisions of this article*, direct."

The words in italics were intentionally omitted by the insurer in writing the policy, its purpose in so doing being to prevent any liability attaching to itself by reason of any mistake made

[1] U. S. Fid. Co. *v.* Board of Education of Somerset County, Ky. Ct. of Ap. ; 86 S. W. 1120.

[2] See to the same effect State Revenue Agent *v.* Saunders, *et al.*, 89 Miss. 784; 42 Sou. 602.

[3] 88 Md. 111; 41 Atl. 31.

by the board in ordering the payment of any moneys by the "risk." It further appeared that the insurer would not have executed any policy, the effect of which would be to guarantee the legal correctness of the orders of the board in addition to the honesty and integrity of such "risk," his faithful performance of duty and a strict compliance with the orders of his superiors. On this state of facts the court held to a strict construction of the scope of the insurer's liability maintaining that such liability was not to be extended by reading the policy in connection with the statute, but depended exclusively on the language of the policy itself. Under this construction, payments of the treasurer illegally ordered by the board to be made were held not to be within the scope of the insurer's liability under the policy.

The right to vary the terms prescribed by the statute for the bonds of a public official was before the South Carolina Supreme Court,[1] which, in passing upon the question laid down the principle that where one provision of such a bond or policy is in harmony with the statute under which it is given, and the other not, force and effect should be given to the one in harmony with the statute.

It is often contended by surety companies issuing official bonds that liability thereunder has not attached because the bond so furnished does not conform to the statute governing the same. In this connection it may be said that a bond intended by the insured named therein to be an official bond of a public officer and under which said public officer is assumed to act, was held in Alabama to be by force of the statutes of that state [2] the official bond of such officer. The court further held that it was of no consequence that the bond was executed payable and conditioned differently from that which the statute required for official bonds.[3]

It may be said as a general rule that where the statute does

[1] Walker *v.* Holtzclaw, 57 S. C. 459; 35 S. E. 754.

[2] Code §§ 3070, 3087, 3089.

[3] U. S. Fid. & Guar. Co. *v.* Union Tr. & Sav. Co., 142 Ala. 532; 38 Sou. 177.

not provide in express terms for a bond according to the conditions of one actually furnished, that although the same may not be strictly in conformity with the statute, if it does not run counter to the statute and is neither *malum prohibitum* nor *malum in se*, it is a valid bond although not in terms directly required by the statute.[1]

§ 145. **Attachment of Liability when the Bond contains Provisions in Excess of Statutory Requirements.** — In a recent Alabama case the Supreme Court of that state had occasion to construe certain statutory provisions governing the subject-matter of official fidelity bonds.[2]

It appeared that one section of the code of that state provided that whenever any officer required to give a bond acts under a bond which is not as prescribed by law, such bond should stand in the place of the official bond, subject, in case any of its provisions were broken, to all the remedies which the person insured thereby might have maintained on the original bond, if executed according to law. The court held in this case that where a public officer acted under a bond executed as an official bond, the compensated surety issuing the same was liable, even though the "risk" named in such bond did not execute it, and even though it impaired no obligation on the part of such "risk" to the insured. In giving its opinion in this case, the court spoke as follows:

"A bond executed by the obligors therein, being the official bond of a public officer, and which such public officer acts under, is by force of the statute the official bond of such officer, and in legal contemplation and effect, such bond is payable and conditioned, as the statute requires such official bond of such officer to be payable and conditioned.

"That the bond sued on in this case was enjoined by the obligors, being the official bond of Wm. H. Parks as registrar in chancery for the district, the statute of the county of Montgomery declared its own terms fully administered. That said Wm. H. Parks acted as such registrar in chancery under such bond and was so acting thereunder at the time of the default complained of is shown in controversy. It

[1] See U. S. *v.* Dickerhoff, 202 U. S. 302.

[2] Bromberg *v.* Fid. & Dep. Co., 139 Ala. 338; 36 Sou. 622.

is therefore of no consequence that the condition of the bond is different from that which the statute prescribes for official bonds, nor of any consequence that the condition expressed in the bond may have been broken by the officer. The condition which, though not written in this paper, is as essentially a part of it for all the purposes of its own case as if it alone were written into it, is that the officer, Wm. H. Parks, will faithfully discharge the duties of the officer of registrar in chancery during the time he continues therein or discharges any of the duties thereof,[1] and the obligors thereon are liable for any breach of its conditions for the use and benefit of every person sustaining dâmages by such breach.[2] It would be immaterial whether such bond is in terms payable to the state. The law makes it so payable. It would be immaterial to the surety's liability whether Parks executed it. The surety is liable whether or not he did. And it is immaterial whether the instrument, though signed by Parks, yet on its face embraced no obligation in the bond. On the other hand, if no account is to be taken of, and no consideration is to be given to, the several stipulations and conditions set down in this paper which tend to limit the liability which an official bond embraces or to clog or impeach the remedy for the enforcement of such liability, the right of recovery is as if the bond had expressed the statutory conditions and these only, and action upon it is maintainable under the same conditions."

§ 146. **Liability under Official Fidelity Bonds for Acts or Defaults occurring before the Execution of the Bond.** — A leading case on this general subject is that of Independent School District, etc. *v.* Hubbard, *et al.*[3] The facts in this case were as follows: One Hubbard was chosen treasurer of a school district in September, 1893, and each year thereafter until March 28, 1898, when a successor was chosen. At this time, according to his books and those of the school district, he should have had on hand, ready to turn over to his successor, $50,174.31. When this amount was demanded by his successor in his office, he failed to turn it over, and an action was instituted for the recovery of the amount against the defaulting treasurer and the American Surety Company, which had issued a fidelity bond on such treasurer for a period of one year only, commencing September 20, 1897, and ending

[1] Code 1896, § 3070. [2] Code 1896, § 3087.
[3] 110 Ia. 58; 81 N. W. 241.

September 20, 1898. The issues raised by the answer of the insured involved the settlement of Hubbard with the School Board in September, 1897, and likewise went to the validity of the bond itself. The court in its opinion said:

"According to the settlement made, the treasurer should have had in September, 1897, the sum of $48,339.08, and he is presumed to have had on hand at that time all the funds with which he was chargeable. If the settlement of Hubbard was made and all the funds and property of the district were actually produced as required by law, such settlement in the absence of fraud or mistake is conclusive, and no inquiry will be tolerated concerning the course from whence any of the money was derived. This duty of settling and requiring the production of funds before approving the bond, however, is due to the public, and not to the surety. Even in the absence of settlement, he is liable for any defalcation during the life of the bond. The board of directors, as such, were under no obligations to look after the interests of the American Surety Company, or to protect it from liability. But the surety cannot be held liable for funds not produced at such settlement, and which were appropriated by the treasurer during some previous term. As proof of a settlement established a *prima facie* case, the burden is cast on the surety to show the failure to produce funds, and their misappropriation prior to the taking effect of his bond. The statutes contemplate the actual production of money belonging to the public in making these settlements. Taxes are paid in money, which is turned over to the school treasurer. He has no authority under the law to invest or deposit it, or to pay it out, save under the direction of the board on orders duly signed for the expense of the district. Having no legal right to change its form, how can he be permitted to produce any balance in his hands, except in the kind he has received?

"It must not be overlooked, however, that these settlements and the production of funds are intended for the security of the municipalities by insuring punctuality and responsibility of public officials, and form no part of the contract with the surety. The surety may insist on the strict construction of his contract and that no misrepresentation be practiced in its procurement. But it is no part of the obligee's duty to furnish him information. This he must ascertain for himself. Even if the board knew the treasurer had been using the money of the district during a prior term, they were not bound voluntarily to warn the surety of his dishonesty. They might remain passive and, if the bond were sufficient, approve it.

"The authorities relied on by the appellant relate to the duty of

individuals or private corporations to sureties and are not in point. The surety is not in a position to complain, because of the failure of his principal to produce the money at settlement. The presumption of law is against defalcation, and to overcome this he must go further and show, not that the money was not produced, but that his principal did not at the time liability on the bond attached have it in his possession or control, for if the money was within the keeping of him for whom the surety vouched, there was no misappropriation. The statutes do not authorize the school treasurers to loan or deposit public funds. Nor do they (the board of directors) at their annual settlements with him, treat certificates of deposit, drafts, checks or other evidences of debt as cash; and as the law contemplates the production of money, the good faith of officials making settlements with custodians of public funds in examining evidences of indebtedness of any kind ought not to be considered. Their good intention could have no effect upon the treasurer's account or what he had done with the district's money. In accepting anything other than that required by law they are derelict in the performance of their duty. If, however, they do take into account certificates of deposit and other evidences of debt which actually represent money, and the case could and would have been produced by the treasurer had the board so desired, it is not perceived wherein the surety has suffered harm. In such a case these actually represent money. Had the money been borrowed temporarily for use in settlement, it for the time being would have become the property of the district, and its return in satisfaction of private obligations, when incurred for the purpose of procuring it, would have operated as a new conversion, for which the surety on the new bonds would be answerable. Whether it might be followed by the district to the hands of one receiving it with knowledge, we need not now inquire. Whatever may become of money after being produced, for the time being it is part of the public funds, and should be treated as such. If thereafter used to satisfy private obligations made in acquiring it, this is a conversion after settlement and not before. If the money was in any way brought into the treasury, even though with the intention to afterwards withdraw it, and it was in fact thereafter abstracted, this surety is responsible."

Again, on this same general subject the court spoke as follows:

"As a general rule, the sovereign power is not charged with duties or obligations to individuals and the exercise of its authority is not controlled by any rights which they may assert, except in the cases

where the constitution has expressly fixed limits to such exercise. And where a bond runs to a municipal corporation or a public officer, the obligee is a mere representative of a sovereign power whose rights, powers, duties, and liabilities are fixed by statute, which not only charges the sureties with notice of the extent thereof, but binds them as well as the obligee. Thus the obligee takes no power by intendment, or by his own acts or omissions of any other person; consequently questions between the sureties and the obligee in an official bond are probably to be regarded as part of those which relate to the liabilities rather than the rights of sureties. With reference to the subject of bonds of municipal officer, the United States Supreme Court in Hast *v.* United States [1] said, the government is not responsible for the torts or the wrongful acts of its officers. Every surety upon an official bond to the government is presumed to enter into his contract with full knowledge of this principle of law, and to consent to be dealt with accordingly. The government enters into no contract with him that its officers shall perform their duties. A government may be the loser by its officers, but it never becomes bound to others for the consequences of such neglect, unless it be by express agreement to that effect."

Under Michigan statutes, providing that the city treasurer shall hold office for one year from the second Monday in April of the year when elected, and until his successor has qualified, the time between the election of a successor and the time he actually qualifies is a part of the preceding term, though the party elected is his own successor. Where the bond of a city treasurer elected to succeed himself is conditioned "that if he shall perform the duties of his office for and during the time for which he was elected, and shall account for and pay over all sums of money that shall come into his hands as such treasurer," etc., the insurer issuing such insurance bond will not be liable for any defalcation occurring prior to the time of the acceptance and approval of the bond by the common council, though it is of a prior date, since the term for which the bond is given does not commence until such bond is accepted and approved.[2]

Where the terms of a bond clearly show that it was intended to be retrospective as well as prospective, the sureties may be

[1] 95 U. S. 316.

[2] City of Grand Haven *v.* U. S. Fid. & Guar. Co., 87 N. W. 104.

held liable for defaults accruing before the execution of such bond. A bond of an officer recited that he had been elected for the year beginning January 1, 1885, and ending December 31, 1885, and had accepted the office, and it was conditioned that if he should faithfully perform the duties of his office "during such year the bond should be void and of no effect, but otherwise to remain in full force and effect." The officer was not elected until some time after the first of the year, but had held successive terms and been continually in office for several years before and after 1885. It was held, that the surety made himself responsible for the defaults of the entire year of 1885. Presumably money had come into the officer's hands and should have been still in his possession and the burden was on the surety to prove that the funds presumably in the hands of his principal had been misappropriated before he became liable on the bond.[1]

But where it is clear that the engagement of the insurer is for the future alone, it cannot be made liable for the past, as to which it has not covenanted.[2]

§ 147. **Duration of Liability under Official Fidelity Bonds. — General Remarks Thereon.**—With respect to the duration of liability under official fidelity bonds it is our purpose to ascertain whether the rules of law governing the same are materially different from those applicable to private fidelity bonds.

With respect to the duration of liability in case of policies covering public officials, the only questions of any difficulty likely to arise, are those relative to the question of when such period of liability terminates. Such policies are customarily issued pursuant to some statutory provision regulating the duties of the office, and for this reason there has been evinced a tendency on the part of certain courts to establish (in the

[1] McMullin *v.* Winfield Bldg. & Loan Ass., 64 Kan. 298; 67 Pac. 892; see also Fid. & Dep. Co. *v.* Mobile Co., 124 Ala. 144; 27 Sou. 386; U. S. Fid. & Guar. Co. *v.* Commonwealth, 31 Ky. L. Rep. 35; 101 S. W. 360; Nat. Sur. Co. *v.* Di Marsisco, 105 N. Y. Sup. 272; 55 Misc. 302.

[2] Thompson *v.* Am. Sur. Co., 170 N. Y. 111; 62 N. E. 1073.

case of bonds furnished by private parties) a legal presumption that bonds issued pursuant to such statutes are to continue in full force and effect during the entire period contemplated by the statute as the term of such office.

Where definite and unambiguous language is employed in the policy with reference to the period of liability thereunder, the rule undoubtedly is that such period is not to be extended by implication or forced judicial construction, beyond that named in the contract.[1]

But where words defining the period of liability are ambiguous or uncertain, then in such case, the courts would undoubtedly adopt a construction most favorable to the insured.[2] This on the principle that as the insurer is ordinarily charged with the duty of preparing the contract, and this necessarily embraces the correlative duty of using certain and unequivocal language, it would be unjust and inequitable to permit such insurer to receive the most favorable construction, of blind and obscure phraseology of its own choosing.[3]

In the case of official fidelity bonds the rule undoubtedly is that the intention of the parties must govern, and if such intention is evidenced by language prescribing a period of liability less than that of the term of office of the "risk" named in the policy, effect must be given to the intention so expressed.[4]

However, in the absence of specific limitations in the policy as to the period of liability, the rule would seem to obtain that inasmuch as the policy was issued for the purpose of securing the faithful performance of official duties, it must be construed as to time with reference to the term for which the "risk" therein named was elected or appointed. In such a case, in

[1] See Walker *v.* Holtzclaw, *et al.*, 57 S. C. 459; 35 S. E. 754; Dorsey *v.* F. & C. Co. of N. Y., 98 Ga. 456; 25 S. E. 521.

[2] Am. Sur. Co. *v.* Pauly, 170 U. S. 133.

[3] See Jaeckel *v.* Am. Cr. Ins. Co. of N. Y., 54 N. Y. Sup. 505; Indemn. Co. *v.* Wood, 73 Fed. 81; 19 C. C. A. 264.

[4] See Walker *v.* Holtzclaw, *et al.*, 57 S. C. 459; 35 S. E. 754; State to the Use of, etc. *v.* John E. Hill, *et al.*, 88 Md. 111; 41 Atl. 61.

intention, all statutes relating to commencement, duration or termination of the term of office of such "risk" are to be treated as part and parcel of the policy itself. The insurer under such circumstances is presumed to know the extent of the term of office of the "risk" and to have intended to bind itself to the extent and for and during the same period that the "risk" was bound to the public for the faithful performance of the duties of his office.

Under this principle, if there is a statute providing that a certain public officer covered by a policy of the character outlined above shall continue to hold his office until his successor is appointed or elected and qualified, then the insurer is liable on the policy of the "risk" holding such office until his successor is so appointed or elected and qualified.[1]

However, it would be unreasonable to extend this principle to unconscionable periods of time not within the fair contemplation of the parties at the time the policy was issued.

Under Michigan statutes providing that the city treasurer shall hold office for one year from the second Monday in April of the year when elected, and until his successor has qualified, the time between the election of a successor and the time he actually qualifies is a part of the preceding term, though the party elected is his own successor. Where the bond of a city treasurer elected to succeed himself is conditioned "that if he shall perform the duties of his office for and during the time for which he was elected, and shall account for and pay over all sums of money that shall come into his hands as such treasurer," etc., the insurer issuing such insurance bond will not be liable for any defalcation occurring prior to the time of the acceptance and approval of the bond by the common council, though it is of a prior date, since the term for which the bond is given does not commence until such bond is accepted and approved.[2]

Attention is called in this connection to the case of Mayor

[1] City of Grand Haven *v.* U. S. Fid. & Guar. Co., 128 Mich. 106; 87 N. W. 104.

[2] City of Grand Haven *v.* U. S. Fid. & Guar. Co., 128 Mich. 106; 87 N. W. 104.

etc., of Brunswick *v.* Harvey, *et al.*[1] It was there held that where a fidelity and guaranty company entered into a bond with the authorities of a municipal corporation to guarantee the city against the fraud and dishonesty of the city treasurer, the obligation thus given is not a statutory but a voluntary bond. To it, for this reason, if for no other, Section 263 of the Political Code is not applicable. Where under such bond the treasurer agrees merely to enter into an obligation to save the city harmless and makes no promise or covenant to the city, the company and the sureties are not jointly liable on such bond.

Where suit is brought upon such bond and the allegations of the petition clearly show that the action is predicated upon the original bond only, an amendment seeking to recover upon two other bonds given subsequently for a like amount and purpose, and adopting by reference the terms of the original bond, was not allowable, though the petition alleged that the bond sued on had been renewed from time to time. The renewals being separate and distinct contracts, the amendments sought to add a new and distinct cause of action.

Where in such bond it was stipulated that the liability of the company should be limited to such losses as should occur during the continuance of the bond or any renewal thereof, or be discovered during said continuance, or within six months thereafter or within six months from the death or dismissal or retirement of the treasurer from the service of the city, and that upon the issuance by the company of any subsequent bond guaranteeing the fidelity of the treasurer, the liability under the original bond should cease and determine so that no two bonds should be operative at the same time, the company is not liable under the original bond for any loss not discovered until more than six months after the expiration of the said bond, although such loss was discovered within six months from the dismissal of the employee and during

[1] 114 Ga. 733; 40 S. E. 754.

the continuance of one of the subsequent bonds. In making this holding the court spoke as follows:

"Instead of giving the bond required by the charter, Harvey gave one signed by the Fidelity & Guaranty Company, which was in the nature of a policy of fidelity insurance, insuring the city against his fraud and dishonesty. While his name was signed to this bond, he, as before recited, made no promise or covenant to the city, but merely undertook to save the company harmless. A careful examination of the bond will show that it is not in the nature of a statutory bond at all, but is in its nature a policy of fidelity insurance. The company agreed with the city to pay any loss the latter might sustain by reason of Harvey's fraud or dishonesty, and the application is hedged about with many conditions and limitations. Not being a statutory bond this obligation must be dealt with as a common law bond. Being a bond of this nature it makes the company liable under its provisions only; and the above cited section of the code cannot possibly be applied to such a bond, even if it could ever be applied to the bonds of officers of municipal corporations. . . .

"The original bond was terminated by the subsequent renewals and the latter were in fact new and distinct contracts which adopted by reference all the terms and conditions of the first. That such renewals of bonds or contracts of this nature are new and distinct contracts there can be no question. All the authorities which we have examined upon this subject so treat them."

In general concurrent official bonds given by a public officer during any one term of office are cumulative, and the new bond does not discharge the old one.[1]

A most instructive case in this immediate connection is that of Fidelity & Deposit Company of Maryland *v.* Libby.[2] A bond of indemnity not stipulating how long it shall remain in force, but covenanting that so long as it shall so remain the obligor shall be paid an annual premium in advance, does not require the payment of the premium so as to continue the obligation, but leaves the obligee at liberty to decline to make payments and thus put a period to the contract so far as the rights of third persons are not affected.

Plaintiff contends that it is also implied that the obligation

[1] Fid. & Dep. Co. *v.* Fleming, 132 N. C. 332; 43 S. E. 899.
[2] 72 Neb. 850; 101 N. W. 994.

was to continue during the encumbancy of Libby under his then present appointment as deputy, and that he was not discharged from his office at the time of the giving of the new bond, but remained continuously therein, and the county board were powerless to impair the obligation of the contract or to release the plaintiff from its obligation thereon. We expect that if it should turn out that Libby has defaulted since the expiration of the first year, the plaintiff will entertain a different opinion. The fair inference from the recitals in the application of which both the treasurer and the county board had full knowledge, is that the plaintiff undertook to become and remain bonded so long and so long only as the agreed annual premium should be paid in advance. In this respect the contract is of the same character as the ordinary policy of insurance to which it is generally analogous, and out of which it grew. It is a contract for one year, renewable annually by the payment of a stipulated premium. If the premium is not paid, it lapses or ceases to be obligatory as between the parties to it except as to past transactions, although there may be or may not be circumstances continuing it in force as to interested third persons, about which we express no present opinion. If in the present instance the county board might have perpetuated the obligation by the reliance upon estoppel in ignorance of the delinquency of the second annual premium, it does not occur to us that they were bound so to do, or that the plaintiff has been injured or has any just ground of complaint because they saw fit to discharge estoppel which we have doubt they had power to do, and did effectively do. The appointment of a deputy county treasurer is not for a fixed term, but is revocable at pleasure. There was no formal revocation and reappointment in this instance, but the conduct of the deputy and of the county board was with the knowledge and concurrence of the treasurer and we think amounted thereto in practical effect. Whether such a bond would be insufficient for the induction into office of a person elected for a fixed term of more than a

year, or if not, whether deferred premiums would be recoverable in such cases are questions not involved in this case. Seemingly one consequence or the other is inevitable. We are also of the opinion that the instrument in controversy is not a legal contract, but derived whatever obligatory force it has from principles of estoppel.

It has been held that where an official on reëlection presents a bond for the ensuing year, the language of which indicates a new obligation, it does not constitute a renewal of a former bond even though it incorporates the covenants thereof.[1]

§ 148. **Duration of Liability where Successive Fidelity Bonds are given by Public Officials.** — The general rule is that where successive fidelity bonds are given for the faithful discharge of a public trust during one term of office, that the same are cumulative and that the giving of a new bond under such circumstances does not discharge the old one.[2]

In construing an official bond the Supreme Court of Ohio spoke as follows with reference to the duration thereof:

> "It will be noted that there is no definite term stated for the duration or life of the obligation. That feature is left entirely to inference. It therefore cannot be determined in this case except by reference to the application. . . . One thing is certain. The contract is, as to duration, at least ambiguous. The bond contains no express declaration on the subject, and the application, as hereinbefore recited, justifies the understanding by the applicant that its continuance depended upon a renewal at the end of the year by the payment of the annual premium, and it is hardly conceivable that the company, when it accepted the application and issued the bond in good faith supposed that it was to be bound during all the years that the same officer might serve as colonel, when at the same time the annual premiums, the basis of its contract, were not being paid; and that its only recourse would be to resort to an action to recover. The contract is silent as to the party who may exercise the option to continue

[1] Sherman *v.* Harbin, 125 Ia. 175; see generally Wapello City Sav. Bank *v.* Colton, *et al.*, 133 Ia. 147; 110 N. W. 450.

[2] Fid. & Dep. Co. *v.* Fleming, 132 N. C. 332; 43 S. E. 899; see also Nat. Sur. Co. *v.* Di Marsisco, 105 N. Y. Sup. 272; 55 Misc. 302; but see *contra* Mayor of Brunswick *v.* Harvey, *et al.*, 114 Ga. 733; 40 S. E. 754.

or terminate the contract; but clearly if such right belongs with any one, it must belong to the one who has procured the contract and is obliged to pay the premiums."

Upon the foregoing state of facts, the court made the following holdings:

"First, that a bond procured by a state officer to be issued by a bonding company to the state, guaranteeing the faithful performance of duty by such officer, which is in its terms indefinite as to duration, will, in the absence of any stipulation to the contrary, be regarded as remaining in force during the incumbency of such officer on his present term, and where the consideration for such bond moving from the officer to the company is the payment in advance by the officer of a specified annual premium, he will be liable to the company for such payment during the term for which the company is liable to the state on the bond.

"Second, that in a trial to recover against the officer for an annual premium, the application is introduced in evidence by the company as constituting in part its right of recovery, that instrument becomes a part of the bond, and if its language taken in connection with that of the bond imports that the bond is to run indefinitely one year at a time, providing payment of the annual premium is made, the contract will be treated as continuing only upon the condition of mutual assent by the parties, and if such assent is not had the officer will not be liable to the company in such action."[1]

§ 149. **Effect of Extension of Tenure of Office by Order of a Superior.** — The general rule unquestionably is that where it is clearly within the scope of the authority of a superior official to extend the tenure of office of a subordinate for whom an official fidelity bond has been given, that then such extension of tenure of office by executive order will not serve to release the surety upon the bond of such subordinate.[2]

§ 150. **Effect of Extension of Tenure of Office by Statutory Enactment.** — In Sparks *v.* Board of Commissioners of Cherokee County,[3] it appeared that a statute had been passed changing the date of election enacted after a county officer

[1] Bryant *v.* Am. Bond. Co., 77 Ohio 90; 82 N. E. 960.

[2] See generally U. S. Sur. Co. *v.* U. S., 129 Fed. 70; Prescott Nat. Bank *v.* Head, (Ariz.) ; 90 Pac. 328.

[3] (Kan.) ; 91 Pac. 89.

had given an official bond to secure the proper performance of the duties of his office. It appeared that his term of office was thereby extended for one year. The court held that the surety on his bond could not be held liable by reason of any misconduct on his part occurring after the expiration of the time for which he was elected, notwithstanding the bond was given for his good behavior during his continuance in office by virtue of such election, and the state constitution further provided that the county officers should hold their office for a term of two years, and until their successors should have qualified. The court in its opinion spoke as follows:

"The bond in question following the language of the statute, purported to guarantee the good behavior of the sheriff 'during his continuance in office by virtue of such election.' Literally construed, therefore, the terms of the bond were broad enough to cover the misfeasance here complained of. But it is urged with much force that sureties, being favorites of the law, are entitled to any reasonable construction that will relieve them from liability. There is conflict of authority upon the question whether, notwithstanding a statutory provision that an officer's term shall continue until his successor has qualified, a bondsman's liability does not cease as soon as a reasonable time has elapsed to permit such qualification, even although it does not take place.

"It will be conceded that if the bond is an official and an annual one, the obligors are only bound for the defaults that occurred during the year for which the bond was given. The contract of a surety is favorably regarded by the law, and even in cases where the officer is authorized to hold over his term and until his successor is elected and qualified, the liability on the official bond is not extended beyond the duration of the term. When an officer is chosen for a term of limited duration, and a bond for the faithful performance of his duties is given, the presumption is that the obligors or sureties only contract for the faithfulness of the officer during that time, and the obligation of the sureties is not extended by the mere fact that such officer is reëlected, or for any reason holds over the term.

". . . It is stated (in 27 A. & E. Encyl. of Law, 535) 'where the term of office is extended by statute after the execution of the bond, the sureties thereon are not liable for the faults occurring during the extended term, although the statutes provide that the officer shall continue in office until his successor is elected and

qualified.' The grounds of the decision are shown by this excerpt from the opinion:

"No consideration of the interests of the public will justify a court in extending by construction the obligation of a citizen under his contract beyond the scope of its natural import. The contract which embodies the obligation, like any other contract, must be construed to give effect to the intention of the parties, and that intention is to be gathered from the language employed and the circumstances surrounding the execution of the instrument. Now, what were the circumstances surrounding the execution of this bond and what length of time would these bondsmen naturally think they were contracting with reference to it? A correct answer to the last question determines their liability. There need be no artificial rules of law applied. It is a simple question of intention gathered from the language of the contract read in the light of the surrounding circumstances. At the time this bond was given, the term of office of the treasurer, as provided by law, was two years. It is argued that the bondsmen entered into this obligation in view of the possible modification of their liability by the Legislative Assembly, and with notice that the Legislature would have a right to continue the incumbent in office beyond the term for which he was elected. So far as the first proposition is concerned, the Legislature would not have any right to pass a law that would change the terms of the contract, or in any way impair its obligation; and so far as the last question is concerned, while the sureties might be held to take notice that the Legislature could extend the term they would not be required to take notice that the Legislature, in such an event, would make no provision for the giving of a bond by the treasurer for the extended term. The sureties had a right to take notice of the law as it existed, and to contract with reference to the law as it existed, that is, the law which would naturally be in their minds when they entered into the contract. And the idea that they would at such a time enter into a speculative calculation of what the law might be in the future, and shape their contract with reference to such possible change, is a strained one. The law at that time made the office one of definite term. That term was two years, and the sureties had a right to, and no doubt did, take that law into consideration, and that was the law that was imported into their contract. There is no doubt that the central idea was that the term was for two years. This was the ordinary state of affairs and the ordinary time for which bonds for county officers were given. A man would willingly go on a bond for two years, but would hesitate or absolutely refuse to act for a longer period."

§ 151. **Effect upon Liability under an Official Fidelity Bond, by Reason of the "Risk" holding over, after the Expiration of his Term.** — The trial court in American Bonding Company of Baltimore *v.* Bryant,[1] held that where an official fidelity bond was given by an officer of the Ohio National Guards, pursuant to statute, such officer was liable after the close of his term of office until a release was obtained by the furnishing of another bond, or by safely returning the property in his custody, which came within the scope of his liability under the bond, or by turning it over to his successor in office after the latter had duly qualified.[2]

§ 152. **Duration of Liability as Affected by Reëlection to Office.** — Official bonds given by an officer during any one term of office are cumulative, and the giving of a new bond upon his reëlection to the same office does not have the legal effect in law of discharging the liability under the old bond.[3]

"The general rule as touching the extent of the obligation of the surety on official bonds is, that the obligation by intendment will be confined to the official term about to commence, or current at the time such bond comes into existence; and when the office is annual, the parties to the bond are presumed by law to bind themselves accordingly, if there are no words in the bond clearly extending to a future term. But when the bond provides that the officer is to be chosen annually, and holds his office until another is chosen and qualified in his stead, the sureties are bound only for the year for which he was chosen, and for such further time as is reasonably sufficient for the election and qualification of his successor, but no longer. When a bond is conditioned for the faithful performance of the principal's duties during his continuance in office, without specifying the length of time, the surety is liable for one year only, the term of the principal being limited to that time."

§ 153. **Duration of Liability as Affected by Resignation from Office.** — It goes without saying, that whenever the "risk" named in an official fidelity bond, resigns from office,

[1] 7 Ohio Cir. 399.

[2] See same case on appeal, Bryant *v.* Am. Bond. & Tr. Co., 77 Ohio 90; 82 N. E. 960.

[3] Fid. & Dep. Co. of Md. *v.* Fleming, 132 N. C. 332; 43 S. E. 899.

and such resignation is accepted by the proper legal authority, all future liability under the bond, covenanted to cover defaults in the performance of such duties, likewise ceases. This on the principle that when a "risk" ceases to be either a *de jure* or a *de facto* officer, all liability on his official bond given to secure the faithful performance of a public office, *ipso facto*, ceases.[1]

§ 154. **Scope of Liability. — General Remarks Thereon.** — On the subject of the scope of liability in official fidelity bonds attention is called to the case of National Surety Company *v.* United States.[2] The court held with reference to the scope of liability under an official fidelity bond, covering the faithful performance of duty by a letter-carrier that the duty of collecting letters and packages to be registered, imposed upon letter-carriers by the order of the Postmaster-General on December 5, 1899, was within the scope of the duties of a letter-carrier and germane to previous duties pertaining to the position. The court held that such a bond covered the faithful discharge of the duties and trust imposed upon such letter-carrier either by the postal laws of the United States or the rules and regulations of the post-office department of the United States, and as such, under the facts stated above, bound the surety for the faithful performance by the "risk" of the duty of collecting letters and packages to be registered, which duty was not imposed upon the "risk" until after the bond was executed, but during the term thereof. The court in its opinion in this case spoke as follows:

"The surety in the case at hand, agreed with the United States to be liable for the faithful discharge by its principal, Eich, of all of the duties imposed upon him as a letter-carrier, either by the postal laws of the United States, or by the rules and regulations of the post-office department of the nation. When this bond was executed, the United States had the right and power, by act of Congress, and the Postmaster-General had the right by rule or order to increase, diminish, or modify the duties of the principal in this bond as a letter-carrier,

[1] See Mayor of Brunswick *v.* Harvey, *et al.*, 114 Ga. 733; 40 S. E. 754.
[2] 129 Fed. 70.

at any time they saw fit; and all the parties to this contract were aware of this fact. The proposition has become too well settled to admit of discussion, that the obligation of a surety for the faithful discharge of the duties of an office, according to the laws and regulations which prescribed those duties, made to one who has the right and power to change such laws and regulations at any time, is in its true interpretation and meaning, a contract for the faithful discharge of the duties of the office according to the laws and regulations, not only as they are at the time when the bond is made, but also as they shall subsequently become during the term of the bond, provided only that subsequent legislation or regulations adds no new duty or responsibility which is not germane to the duties or within the scope of the office at the time of the making of the bond. All duties prescribed by subsequent legislation or regulation, which are of the same kind as those previously pertaining to the office, and which are within its scope, and which naturally belong to its business, are within the reasonable contemplation and evident intention of the parties to such a contract because they knew the necessity and probability of changes in the duties of the office and the bond binds principal and surety alike for their faithful discharge."

Again the question of the scope of liability under the official bond of a tax collector was before the Supreme Court of Alabama, in the case of Fidelity and Deposit Company *v.* Mobile County.[1] In that case the court spoke as follows:

"As against the county or state there is no presumption that a tax collector has misappropriated, converted to his own use, or embezzled taxes collected by him, from the mere fact that he has failed to pay over such taxes at the time he was required by law to pay them over. To the contrary, if he carries such sums past one day of settlement, the presumption is that he still has the money and will pay it over on the next day of settlement; and if he has such money in hand at any such subsequent time when an additional bond is required of him, given and approved, his failure thereafter to account for and pay over the same as required by law is a default occurring subsequent to the execution of such bond, for which the sureties thereon are liable, and the fact that he had only a certain sum on deposit at one or two specified banks at the time the bond was given, manifestly has no legitimate tendency to show that he had no other funds of the county at that time, or that he had embezzled the other moneys collected by him.

"It is upon these considerations that we base our conclusion that to

[1] 124 Ala. 144; 27 Sou. 386.

say the least, an additional bond is security for all moneys not actually converted to the principal's own use prior to its approval, and that the fact that moneys were collected and should have been, but were not, paid over prior thereto, and that at the date of approval he did not have such funds on deposit with the banks or persons with whom he usually deposited his collections, are irrelevant to show a conversion and default by him, and in respect of such moneys before the execution of the new and additional bond. The tax books delivered to Lott (the 'risk') are not set out in the transcript, but enough therein appears to show that they were made out, examined, corrected, and allowed by the board of commissioners, and taken in connection with the evidence of the corrections, made by the board, the noting thereof in the books, the extension of the amounts opposite the name of each tax payer, etc., the certificate appended to the books is a substantial compliance with the statutory requirement in force at the time. It follows that the books having been thus examined, corrected, and allowed by the board, this certificate, assuming the necessity for any certificate, vested in Lott the power and authority to collect the taxes set down in the books, and rendered him liable for failing to collect the same." [1]

§ 155. **Liability for Non-Official Acts.** — It would be entirely safe to assert that no surety, whether compensated or otherwise, should be held liable under an official fidelity bond for acts of the "risk" resulting in loss to the insured which were

[1] See the following cases as to scope of liability: Auctioneers' Bond, Plumer *v.* Bankers Sur. Co., *et al.*, 101 N. Y. Sup. 529; 52 Misc. 143; Tax collector, Commonwealth *v.* Perrego, 218 Pa. St. 314; 67 Atl. 621; Sanford *v.* U. S. Fid. & Guar. Co., 116 Ga. 689; 43 S. E. 61; U. S. Fid. & Guar. Co. *v.* Board of Education, 27 Ky. L. Rep. 863; 86 S. W. 1120; State, etc. *v.* Fid. & Dep. Co. of Md., 99 Md. 244; 57 Atl. 669; Sheriff's Bond, Commonwealth *v.* Mulnor, 23 Pa. Sup. Ct. 1; County Auditor, Board of County Commissioners *v.* Sullivan, 89 Minn. 68; 93 N. W. 1056; Consular Bond, United States *v.* Ballantine, *et al.*, 138 Fed. 312; Clerk of Court's Bond, State to the use of Smith *v.* Turner; 101 Md. 484; 61 Atl. 334; County Treasurer's Bond, Commonwealth *v.* Scranton, 214 Pa. St. 595; 64 Atl. 321; Montgomery Co. *v.* Cochran, 126 Fed. 456; Policeman's Bond, Connelly *v.* Am. Bond. & Tr. Co., 113 Ky. 903(?); 69 S. W. 959; Notary's bond, Stork, *et al.* *v.* Am. Sur. Co., 109 La. 713; 33 Sou. 742; see generally H. S. L. Ass. *v.* U. S. Fid. & Dep. Co., 197 Pa. St. 177; 46 Atl. 910; see also Nat. Sur. Co. *v.* Di Marsisco, 105 N. Y. Sup. 272; 55 Misc. 302; U. S. Fid. & Guar. Co. *v.* Commonwealth, 31 Ky. L. Rep. 35; 101 S. W. 360.

performed by such "risk" while acting in an absolutely non-official capacity.

In a recent case decided by a Federal circuit court of appeals[1] it appeared that a deputy county auditor, authorized by law to act in the name of his principal, issued spurious refund orders on the county treasurer in favor of fictitious payees, purporting to be for the refund of taxes received through redemption from tax sales. The deputy county auditor was bound under an official fidelity bond which made the surety company issuing the same responsible, not only to the county, but to any person injured by the deputy's misconduct in office. The latter procured the spurious refund orders to be authenticated by the chairman of the board of county commissioners. After this was done, he forged the names of the fictitious payees therein named to an assignment thereof and sold the same to a bank. The court held that any loss sustained by the bank through its purchase of the orders could not be attributed to the official misconduct of the deputy in issuing the same, but that his action in this regard was his individual act. The court further held that the orders being non-negotiable, the bank was put on inquiry and acquired no greater rights than the supposed payees and had no right to recover any such loss from the county or the surety on the auditor's bond. So in a Kentucky case,[2] it was held that a county judge was not liable on his official fidelity bond for the amount of a trust fund placed in his hands by the committee of a lunatic upon the termination of his trust. This for the reason that the county judge had no authority by virtue of his office to receive such fund.

In a late English case the policy provided that the "risk" (clerk of a city council), who had been appointed to carry out all the ordinary duties of his position, should faithfully discharge the duties of his office and in particular should faithfully, honestly and punctually account to the council for all sums

[1] Nat. Sur. Co. *v.* City Sav. Bank, 156 Fed. 21.

[2] Am. Bond. Co. *v.* Blount, *et al.*, Ky. ; 65 S. W. 806.

of money which he should receive while holding such office. It appeared that during the life of the policy certain work was being carried out by the council under the supervision of an engineer who received the money and paid the men. The engineer resigned, and the "risk" later received the money for the purpose of paying the men and misappropriated a part of it. It was held that it was not part of the ordinary duty of the "risk" to make payments of this kind; that in giving the money as it had to the "risk" for the payment of employees, the insured had increased his duties without the knowledge or consent of the insurer, and that in consequence the latter was discharged from liability under the policy.[1]

A case opposed to the foregoing is that of MacNichols *v.* Canadian Guarantee Company,[2] where it was held that a policy, worded so as to clearly cover the defaults of an official assignee, covers those committed while acting under an unofficial appointment to that position by the consent and direction of creditors.

Sureties on the official bond of a justice of the peace are not liable for moneys collected by him on account of funds placed in his hands for collection without suit.[3]

§ 156. **Liability for Official Acts imposed by New Legislation.** — In the case of National Surety Company *v.* United States,[4] the federal circuit court of appeals made the following statement of the law governing the effect upon the liability of bondsmen where additional duties are imposed upon the "risk" named in an official fidelity bond by acts of the legislature passed after the bond was issued.

"The parties to a bond," remarked the court, "for the faithful discharge of the duties of an office according to the laws and regulations which the officer has the right to change at any time, necessarily contemplates and intends to guaranty thereby the discharge of the duties of the office imposed upon the principal by subsequent legislation or

[1] Wembly Urban Dis. Coun. *v.* Poor Laws, etc. Guar. Ass., 17 T. L. R. 516.

[2] 4 L. N. Can. 78.

[3] State, *ex rel.* MacDonald *v.* Wills, 59 S. E. 743.

[4] 129 Fed. 70.

regulations of the obligee during the term of the bond which are within the scope of the office and are germane to and undoubtedly connected with the "risk's" duty when the bond is made. They do not warrant or intend to guaranty the discharge of duties beyond the scope of the office, disconnected with its business or foreign to its duties at the time of the execution of the bond."

§ 157. **Liability for Performance of Duties not imposed by Law.** — A most important principle of general application is to be found in the opinion of the court in National Surety Company *v.* United States.[1] A letter carrier had been bonded by a fidelity insurance company and while engaged in the transaction of his regular duties had stolen certain registered letters. The court, in passing upon the various questions involved in an action brought by the government against the insurance company, on the letter carrier's bond, spoke as follows:

"The parties to a bond for the faithful discharge of the duties of an officer according to the laws and regulations, which the obligee has the right and power to change at any time, necessarily contemplate and intend to guaranty thereby the discharge of the duties of the office imposed upon the principal by the subsequent legislation or regulation of the obligee during the term of the bond which are within the scope of the office, and are germane to and undoubtedly connected with its duties when the bond is made. They do not warrant or intend to guaranty the discharge of duties beyond the scope of the office disconnected with its business or foreign to its duties at the time of the execution of the bond.

"The agreement of the surety must be strictly construed. His responsibility may not be extended by implication beyond the terms of his bond. An additional liability which his bond does not clearly show to have been within the reasonable contemplation and intention of the parties to it when it was made cannot be imposed upon him by the subsequent action of the obligee or of the principal in the bond.

"But the contract of surety, like all other contracts, must have a reasonable construction, — an interpretation which, while it carefully restricts his responsibility to that which he agreed to undertake, does not fail to hold him to that liability which by the plain terms of the agreement he contracted to assume. The surety in the case at hand

[1] 129 Fed. 70.

agreed with the United States to be liable for the faithful discharge by its principal, Eich, of all of the duties and trusts imposed upon him as a letter carrier, either by the postal laws of the United States, or by the rules and regulations of the post office department of the nation. When this bond was executed, the United States had the right and power, by act of Congress, and the postmaster-general had the right by rule or order to increase, diminish or modify the duties of the principal in this bond as a letter carrier, at any time they saw fit; and all the parties to the contract were aware of this fact. The proposition had become too well settled to admit of discussion that the obligation of a surety for the faithful discharge of the duties of an office according to the laws and regulations which prescribe those duties, made to one who has the right and power to change such laws and regulations at any time, is, in its true interpretation and meaning, a contract for the faithful discharge of the duties of the office according to the laws and regulations, not only as they are at the time when the bond is made, but also as they shall subsequently become during the term of the bond, provided only that subsequent legislation or regulation adds no new duty or responsibility which is not germane to the duties or within the scope of the office at the time of the making of the bond. All duties prescribed by subsequent legislation or regulation, which are of the same kind as those previously pertaining to the office and which are within its scope, and which naturally belong to its business, are within the reasonable contemplation and evident intention of the parties to such a contract because they knew the necessity and probability of changes in the duties of the office and the bond binds the principal and surety alike for the faithful discharge."

In a recent Nebraska case [1] the court spoke as follows:

"In this state the rule is that sureties on official bonds do not undertake to answer for acts done by their principal under color of office, but only for such acts as are done by virtue of his office. Where an officer goes out of the line of his official duty and acts without the scope of his authority, this action, though done *colore officii*, is not a breach of his bond for the faithful performance of his duty.[2] In Wilson *v.* State,[3] it is stated: 'As a general proposition, the obligation of a surety is *strictissimi juris*. The surety has the right to stand upon the letter of his obligation. That the defendants, as sureties upon the official bond

[1] Stephens *v.* Hendee, *et al.* (Neb.) ; 115 N. W. 282.

[2] State *v.* McDonnough, 9 Mo. Ap. 63.

[3] 67 Kan. 447; 72 Pac. 517.

of Wilson, as county attorney of Rawlins County, are liable only for such sums of money as he might lawfully receive by virtue of his office as county attorney, is too well settled to admit of argument.' In Machem Public Officers, § 284, is clearly pointed out the distinction between acts done by virtue of office and those done under color of office in the following language: 'Acts done *virtute officii* are where they are within the authority of the officer, but in doing them he exercises that authority unwisely or abuses the confidence which the law reposes in him, as well as acts done *colore officii* are where they are of such a nature that his office gives him no authority to do them.'

"The condition in the bond which is particularly relied upon for a recovery in this case, and which we think is the only one under which the bondsmen could be held under any circumstances, is in the following language: 'Now if the said Hosmer H. Hendee . . . shall promptly pay over to the person or officer entitled thereto the money which may come into his hands by virtue of his said office,' etc. It is a rule universally recognized that sureties on official bonds can only be held for such liability as comes within the letter of their contracts. The bond in this case holds the sureties only for acts done by virtue of office, and not under color of office, and they are not liable in this case unless it can be stated that Hendee received the money and certificate of deposit by virtue of his office. Under no circumstances that we can conceive of is the county judge entitled to the custody of the personal effects of a decedent prior to the appointment of an administrator. The record clearly discloses in this case that Hendee obtained possession of the money and the certificate prior to the application for the appointment of the administrator. Under no circumstances is the county judge to compel or require the property to be placed in his hands. He had obtained possession of the money and certificate by misrepresentation of the law to the coroner, and while this act may have been done under color of his office, yet it was not by virtue of his office."

§ 158. **Liability of the Insurer for Negligence of the "Risk" under an Official Fidelity Bond.** — It would hardly seem to be safe, in the absence of provision in the bond to that effect or statutory enactment extending the liability under such bonds to cases of negligence on the part of the "risk," to hold that such bonds are broad enough to cover negligent acts on the part of the "risk." Notwithstanding the general principle here referred to, the Alabama Supreme Court has held [1]

[1] Fid. & Dep. Co. *v.* Mobile County, 124 Ala. 144; 27 Sou. 386.

that where tax books were made out, examined or corrected and allowed by the board of commissioners and the taxes extended opposite the name of each taxpayer and certified, the delivery of such tax books and certificates to the collector with authority to collect the taxes renders him liable for any failure on his part to collect the same.

This same court in United States Fidelity and Guaranty Company *v.* Board of Education of Somerset Public Grade Schools [1] made another holding to the following effect: That under the Kentucky statutes creating a district board of education and providing that the tax collector should be under the same responsibility as are sheriffs in the collection of the state revenue, and further providing that the former's sureties should be liable on his bond for all moneys so collected, the surety's liability thereunder is only such as is imposed by law. That such being the case, it becomes the duty of the collector not only to pay over the money which he collected, but to collect all valid tax receipts placed in his hands for collection, and for the reason stated, the court held that the collector's surety was liable not only for taxes collected, but also for those which should have been collected.

Next attention is called to the case of Montgomery County *v.* Cochran, *et al.*[2] Under a statute providing that the proceeds of certain county bonds should be paid to and kept by the county treasurer and that he should be responsible for the safe-keeping of all of the proceeds accruing from the sale of such bonds which may come into his hands in his official capacity the same as other county funds or moneys, the terms "proceeds of sale" and "funds or money" are not limited in meaning to coin and bank bills, but include any other medium of payment authorized by general commercial usage, and the treasurer is equally responsible where he accepted a check given by a purchaser and receipted for the same as the proceeds of the bonds. Conceding that defendant had no right to accept the check,

[1] Ky. Ct. of App., 80 S. W. 1191. [2] 121 Fed. 17.

and that not having actually received money, he was not responsible for its safe-keeping, his acceptance of it and his receipting to the board for the proceeds of the bond by reason of which they were issued and became obligations of the county, amounted to an improper or neglectful performance of a duty imposed by law and he and the surety on his bond were liable for the loss resulting to the county.

In the foregoing case the court spoke as follows:

"Public policy requires that every officer charged with the duty of receiving and keeping public money should be held to a strict accountability. He should be required to exercise the highest degree of vigilance. When loss has fallen on the public through his official act, he should not be permitted to avoid responsibility by averments of the improper or neglectful performance of duties imposed on him by law. To permit such defences would open the door to frauds, which might be practiced with impunity. The treasurer, or other depositary, could lay his plans and arrange his proofs to make good the defence of his sureties by impeaching his own official acts. His own neglect or frauds would become their defence. The condition of the treasurer's bond and considerations of public policy both forbid such defence.

"It is true that the obligation of the surety is subject to the strictest interpretation, and that his liability must be found within the terms of his contract; but where the bond is for the faithful discharge of official duty, and stands as indemnity against its improper or neglectful performance and a loss occurs by the failure to discharge such duty, or from a wrongful act done by virtue and authority of the office, such failure and such act are within the very reason and purpose of the law requiring official bonds."

§ 159. **Liability for Unavoidable Loss of Funds.** — A not infrequent ground for actions upon official fidelity bonds is that based upon the alleged liability of the surety executing such bond for loss of funds entrusted to the "risk" named in the bond so issued, where such loss has been occasioned by the deposit of funds by such "risk" in insolvent banks. The proper method of determining whether such bonds cover liability of this character is to ascertain whether they are fidelity bonds in the proper sense in which that term is used, or whether they are in the nature of absolute guarantee that

the funds shall be turned over to the insured at the termination of the "risk's" employment. If the bond is of the character first referred to, it is safe to say that the party issuing such a bond cannot be held for loss of funds on the part of the "risk" except where the same was occasioned through actual fraud or dishonesty on his part.[1]

On the other hand, where the bond was given as, and can properly be construed as, an absolute guarantee, then the party issuing such bond is liable for failure of the "risk" to turn over the funds entrusted to him to the insured at the termination of his employment, whatever may have been the cause of the loss complained of.[2]

§ 160. **Liability for Penalties incurred by the "Risk" in Connection with the Performance of the Duties of his Office.** — As a general rule the compensated surety on an official fidelity bond can never, in the absence of express provision therefor in the policy, be held liable for penalties incurred by the "risk" in connection with the performance of his official duties. This was in effect the holding of the Supreme Court of Nebraska in Eccles *v.* Walker.[3] In the case just referred to, the court, in holding the surety not liable for a statutory penalty incurred by the "risk" named in the official bond, spoke as follows:

> "Penalties of this character are never extended by implication, nor are sureties held beyond what is clearly within the scope of their undertaking, and when the statute provides a penalty for the doing of or the omission to do certain acts, and does not, by express terms, make the sureties liable, they are not liable for such penalty. . . . We think it is clear, both upon reason and authority, that the surety is not liable for a statutory penalty denounced against his principal unless the statute imposes the penalty so provided."

§ 161. **Liability of the Insurer for Interest collected by the "Risk" on Public Funds.** — The general rule is that where the

[1] See U. S. Fid. & Guar. Co. *v.* Fossati, *et al.*, 97 Tex. 497; 80 S. W. 74.

[2] See Cullinan *v.* Nat. Sur. Co., 79 N. Y. App. Div. 409; Fid. & Dep. Co. of Md. *v.* State to Use of Charles County Commissioners, *et al.*, 98 Md. 162; 56 Atl. 361.

[3] 75 Neb. 722; 106 N. W. 97.

"risk" converts to his own use interest received by him for deposit of public moneys collected and held in trust by him for the insured, such interest paid on such funds while deposited in the bank belongs to the insured in all cases where the "risk" is expressly or impliedly forbidden to retain or claim said interest as his own.[1]

§ 162. **Liability of the "Risk" for Acts of Fraud and Dishonesty.** — Turning now to the character of the acts of the "risk" which come within the scope of a liability under official fidelity bonds, it was held in a recent Alabama case that where a tax levy; being part of the revenue, was erroneously entered in the minutes at a rate less than that fixed by it, and the board thereafter corrected such entry *nunc pro tunc*, and the collector collected the taxes at the rate fixed, and paid over the taxes to the county in excess of the rate originally entered in the minutes and embezzled the balance, that the insurer issuing the fidelity policy on such collector was not discharged from liability thereunder on the ground that the *nunc pro tunc* order, correcting the rate, was void, since such order could not be collaterally attacked.

In this same case it was held that it could not be presumed as a matter of law that a tax collector misappropriated or embezzled taxes collected by him, from the mere fact that he failed to pay them over on a settlement day. The court held, as a matter of law, that the presumption is under such circumstances that the collector will pay them over on the next settlement day. Even the fact that the county collector had taxes in his hand or on deposit which he had collected and failed to pay over on the particular settlement day, after which a new bond was executed, was held not to relieve the insurer from liability thereunder for his failure thereafter to account for and pay over the same as required by law.[2]

[1] See Van Sant *v.* State, 96 Md. 110; 53 Atl. 711.

[2] Fid. & Dep. Co. *v.* Mobile County, 124 Ala. 144; 27 Sou. 386; see also Am. Bond. & Tr. Co. of Baltimore *v.* Milestead, 102 Va. 683; 47 S. E. 853; Stork, *et al. v.* Am. Sur. Co., 109 La. 714; 33 Sou. 742.

Finally, attention is called to the remarks of the court in Fidelity and Deposit Company *v.* Beale,[1] as follows:

"That the contract of indemnity in this case is not for the faithful performance of duty by A. C. Brown, as deputy treasurer of Westmoreland County, but that the guaranty company only undertakes to provide indemnity for the principal for acts of larceny or embezzlement on the part of the employee in the performance of his duties as deputy treasurer. It is true that the surety or guarantor can only be held by the express terms of his contract; it may be that there could be but one measure of recovery against the guarantor, the surety. Derelictions of duty on the part of the deputy, which could not be conclusive as acts of larceny or embezzlement, would not be within the undertaking on the part of the Fidelity and Deposit Company, but this consideration is wholly independent of the general jurisdiction of the tribunal in which the principal, R. H. Stewart, seeks redress for the default of his deputy. It grows out of the contract between the parties. The law did not require Stewart to take any bond from his deputy. In his effort to protect himself against the delinquencies of his deputy, he was at liberty to take a bond with such conditions as to him seemed best. He could have required the surety to indemnify him against all defaults in the performance of his duties, or he could content himself with taking indemnity only against his acts of larceny or embezzlement."

CHAPTER XV

DISCHARGE OF LIABILITY UNDER OFFICIAL FIDELITY BONDS

§ 163. **Discharge of Liability by Rescission and Cancellation of Policy.** — It is a well-settled principle that the surety cannot defend a suit upon an official fidelity bond upon the ground of fraudulent representations made to him by the insured at the time the bond is issued.[2] The foregoing principle is applicable both to cases where a liability under such bond has been asserted by the insured against the in-

[1] 102 Va. 295; 46 S. E. 307.

[2] Bromberg *v.* Fid. & Dep. Co., 139 Ala. 529; 36 Sou. 622.

surer issuing such bond, but is likewise applicable to cases where no such liability has been asserted, but where the insurer seeks to have the bond issued by it cancelled on its application to a court of competent jurisdiction upon the grounds above stated. As a general rule, it may be stated that no executive or administrative bodies have power in the absence of statutory provision to that effect, to release sureties on official bonds.[1]

An exceedingly instructive case on this general subject is that of Ætna Indemnity Company *v.* City of Haverhill.[2] In this case it appeared that the city of Haverhill had applied to the surety company for a bond upon one Glines, the city treasurer.

The application was made by Glines as treasurer in the service of the city, and the questions which he answered were addressed to him in the second person. The following questions, among others, were asked:

23. Do you furnish any additional security covering this position?

24. Have you ever exacted security before?

25. Have you ever applied to any company for a bond?

In answer to the last question Glines gave the name of another fidelity company which had gone surety on a former official bond. His application closed as follows:

"I hereby declare that all the above answers are true; and in consideration of the issue of the indemnity bond or security hereby applied for, and of any further or other bond or security hereafter issued by said Ætna Indemnity Company in my behalf in my present or any other position in this service, I hereby agree to protect and immediately indemnify the company against any loss, damage or expense it may sustain, or become liable for in consequence of this or any other such bond or security granted in my behalf. I hereby agree that any proper evidence of payment by the said company of any such

[1] Fid. & Dep. Co. *v.* Fleming, 132 N. C. 332; 43 S. E. 899. Clement *v.* Reavley, 126 N. Y. App. Div. 215.

[2] 142 Fed. 124.

loss, damage or expense shall be conclusive evidence against me, and my estate of the fact and extent of my liability to the company under this agreement.

"I further agree that said company may decline to issue said indemnity bond hereby applied for, and in case it does issue said indemnity bond, it shall have the right to withdraw or cancel the same whenever it shall see fit; and in any event the company shall not be required to disclose the reasons upon which its action is based, and shall not be responsible for any loss or damage that I might sustain by reason of said action."

In the employer's statement signed by Rowe, the city auditor, the application made by John A. Glines is mentioned, and Glines is styled the "applicant."

The company relied upon a resolution of the city council of Haverhill, establishing "the salaries and compensations of the principal officers," which read in part as follows:

Treasurer and collector of taxes in full for all services pertaining to said office, all fees received in his official capacity to go into the city treasury. The city to furnish bond required by the council, $2000.

While the resolution is expressed inaccurately, in substance it amounts only to a vote of the city council to pay the premium on the treasurer's bond as authorized by the statute above referred to. Certainly the language does not override the nature, object and method of the transaction as otherwise manifested.

It was claimed at the time the application for the bond was made that the city authorities made to the surety company certain material false representations which were the inducing cause which led the surety company to execute and deliver the bond in controversy. It further appeared that on a discovery of the falsity of the representations, the surety company tendered back the premiums received by it, and notified the insured that it claimed that the bond had been obtained by fraud, and that for this reason the insurer rescinded the

bond so issued and demanded the return of the premium. The court refused to permit the surety company to cancel the bond on the grounds stated, and in making this holding spoke as follows:

"Assuming without deciding, that the laws of Massachusetts authorize the city to procure, of its own motion and its own behalf, a bond guaranteeing it from loss through its treasurer; and assuming further, although the assumption would deprive the bond of practical value, that a city, in procuring the bond, may accredit its treasurer, the very official whose honesty is to be guaranteed, so as to be bound by his representations, yet we are of opinion that in the case at bar the city must prevail. There is no evidence that it procured the execution of the bond on its own behalf, or did anything more than to approve the bond which the treasurer gave in compliance with Massachusetts Rev. Laws, Chap. 25, § 72, and paid the surety companies' charge as authorized by Chap. 26, § 23. The instrument in question was not an insurance policy taken out by the city to protect itself from loss through its employees. It was a bond given by Glines, with the company as surety."

Where statutes exist giving to the surety company absolutely the right to be relieved from their liability on official bond, the rule is that the latter is not required to show any cause for seeking to be relieved from such liability, but the right is an absolute one, and the court has no discretion in the matter. If the court from whom such relief is asked refuses to grant the same, the proper remedy is mandamus.[1]

§ 164. **Discharge of Liability by Misrepresentation.** — The same rule obtains here as obtained in the case of private fidelity bonds. An interesting case in this immediate connection is that of Ætna Indemnity Company *v.* City of Haverhill.[2] In this case the execution of the bond was admitted, but the insurer set up a defence of misrepresentation. The answer set up was that the city applied to the company for the bond; that at the time of the application and in order to induce the company to execute and deliver them, the city made to the

[1] U. S. Fid. & Guar. Co. *v.* Peebles, 100 Va. 585; 42 S. E. 310.

[2] 142 Fed. 124.

company certain material false representations concerning Glines by which the company was induced to execute the bonds; that the city then concealed from the company certain material facts for the purpose of inducing the company to execute and deliver the bonds; that on discovery of the falsity of the application and representations the company tendered back the premiums, notified it (the city) that "it claimed the bonds had been obtained by fraud," and rescinded the agreement and demanded their return. The evidence showed false representations by Glines made in the application of the company. The surety company contended that it was not liable on a bond which it has been induced to execute by the fraud of the insured or its agents. The court in its opinion spoke as follows:

"Assuming, without deciding, that the laws of Massachusetts authorize the city to procure, of its own motion and on its own behalf, a bond guaranteeing it from loss through its treasurer, and assuming, further — although the assumption would deprive the bond of practical value — that a city, in procuring the bond, may accredit its treasurer, the very official whose honesty is to be guaranteed, so as to be bound by his representations, yet we are of opinion that in the case at bar the city must prevail. There is no evidence that it procured the execution of this bond on its own behalf, or did anything more than to approve the bond which the treasurer gave in compliance with Massachusetts Rev. Laws, Chap. 25, § 72, and paid the surety's charge as authorized by Chap. 26, § 23. The instrument in question was not an insurance policy taken out by the city to protect itself from loss through its employees. It was a bond given by Glines with the company as surety. The application was made by Glines as treasurer in the service of the city, and the written questions which he answered were addressed to him in the second person. The following questions, among others, were asked:

"23. Do you furnish any additional security covering this position?

"24. Have you ever exacted security before?

"25. Have you ever applied to any company for a bond?

"In answer to the last question, Glines gave the name of another fidelity company which had gone surety on a former official bond. His application closed as follows:

"'I hereby declare that all the above answers are true; and in con-

sideration of the issue of the indemnity bond the security hereby applied for, and of any further or other bond or security hereafter issued by said Ætna Indemnity Company in my behalf, in my present or any other position in this service, I hereby agree to protect and immediately indemnify the company against any loss, damage or expense it may sustain, or become liable for in consequence of this or any other such bond or security granted in my behalf. I hereby agree that any proper evidence of payment by the said company of any such loss, damage or expense shall be conclusive evidence against me and my surety of the fact and extent of my liability to the company under this agreement.

"'I hereby agree that in case said company might decline to issue said indemnity bond, it shall have the right to withdraw or cancel the same whenever it shall see fit; and in any event the company shall not be required to disclose the reasons upon which its action is based, and shall not be responsible for any loss or damage that I might sustain by reason of said action.'

"In the employer's statement, signed by Rowe, the city auditor, the application made by John H. Glines is mentioned, and Glines is styled the 'applicant.'

"The company relied upon a resolution of the city council of Haverhill establishing 'the salaries and compensations of the principal officers,' which read in part as follows:

"'Treasurer and collector of taxes in full for all services pertaining to said office, all fees received in his official capacity to go into the city treasury. The city to furnish bond required by the council, $2000.'

"While the resolution is expressed inaccurately, in substance it amounts only to a vote of the city council to pay the premium on the treasurer's bond as authorized by the statute above referred to. Certainly the language does not override the nature, object, and method of the transaction as otherwise manifested." [1]

An interesting case in this immediate connection is United States Fidelity and Guaranty Company *v.* Commonwealth.[2] In this case it appeared that at the time the official bond was issued the surety company issuing the same was informed by the county judge, who approved the bond, that the accounts of the "risk" were correct. This representation was false, and the court refused to relieve the surety company from

[1] See also State *v.* Pederson, 114 N. W. 829.

[2] 31 Ky. L. Rep. 1179; 104 S. W. 1029.

liability therefor for the reason that the power to make such representation was not within the scope of the authority of the county judge, and that the state, for whose benefit the bond was given, not having authorized him to act for it in this matter, is not bound by him. The foregoing principle, as to the utter lack of power on the part of officials in the employ of the state, to make representations that are binding upon the state, in an action to enforce the liability of a surety company issuing an official bond, is one of the striking points of differentiation between private fidelity insurance bonds and those now under consideration.

§ 165. **Discharge of Liability by Concealment.** — Attention is called in this connection to the case of American Bonding and Trust Company *v.* Milestead.[1] This was the case where a deputy collector of a city had furnished an official fidelity bond to his principal. It appeared that during the continuance of the bond the principal knew that such deputy was failing to remit collections made by virtue of his office. Notwithstanding this fact, the principal continued such deputy in office. The bond issued ran to the principal and bound the deputy in a designated sum against defaults occurring in the conduct of his office. The court held that the insured could not under such circumstances recover for embezzlements of the deputy from the surety company for the reason that the latter was not informed by the insured of the "risk's" failure from time to time to remit collections made by virtue of his office. It appeared in this case that the evidence conclusively showed that the surety company had no knowledge of the deputy's embezzlement even after his discharge by the insured. Under these facts the court instructed the jury that knowledge of facts and circumstances clearly calculated to incite suspicion in the mind of a person of ordinary care and to cause him to make inquiries was sufficient to impute to the jury knowledge of all facts that might have been discovered on such an inquiry, and to which the evidence given furnished a reasonable and

[1] 102 Va. 847; 47 S. E. 853.

natural conclusion. The court further instructed that if the jury believed from the evidence that the insurer had such knowledge, then they ought in the absence of conflicting evidence to find the insured chargeable with notice.

The appellate court approved the foregoing instruction, and in addition thereto observed that mere negligence on the part of the insured named in the policy will not affect the contract of suretyship, but good faith is all that is required. The court held that it was a mistaken theory to suppose that there was on the part of the insured any real duty to make a continuous and diligent search into the life of the "risk" and into the question as to the due payment by him of moneys collected in his official capacity. The court further observed that the rule of law invoked by the insured that whenever inquiry becomes a duty the party bound to make the same is credited with knowledge of all which he would have discovered out of the performed duty, has no application to this class of cases in the absence of such provisions in the contract sued on.[1]

In the case of the Fidelity and Deposit Company of Maryland *v.* Commonwealth,[2] the Kentucky court of appeals used these words:

"To sustain this position that the surety is released, counsel for appellant relies upon that principle of law which is to the effect, if a party taking a guaranty from a surety conceals from him facts which go to increase his risk, and suffers him to enter into a contract under false impressions as to the real state of facts, such concealment will amount to a fraud, because the party is bound to make the disclosure; and the omission to make it under such circumstances is equivalent to an affirmation that the facts do not exist. This principle of law is applicable to transactions between individuals, and between individuals and corporations, but does not apply to public officials."

§ 166. **Discharge of Liability by Breach of Warranty.** — The question as to whether or not the doctrine of warranty as it exists in private fidelity insurance is applicable to official

[1] See to the same effect, McMullin *v.* Winfield Bldg. & Loan Ass., 64 Kan. 298; 67 Pac. 892.

[2] 20 Ky. L. Rep. 788, 1042; 47 S. W. 579; 49 S. W. 467.

fidelity bonds was decided — and we think rightly in the negative — in Commonwealth *v.* American Bonding and Trust Company.[1] It was held in that case as follows: That there is no official duty on the part of a county treasurer to examine the accounts of a tax collector with the county and make report thereon to a person who proposes to become surety for the collector for the ensuing year. If he does so, he is the mere agent of the surety to do what he is not officially obliged to do, and if he or his attorney, duly authorized, makes false answers to the questions propounded by the proposed surety, the county is not responsible for such answers, and the surety is not entitled to relief from liability on its bond by reason of them. Whether, if the surety had called upon the treasurer for a certificate from his officials of the accounts which he was bound to correctly keep and of the balances against the collector for certain years specified, and he had as treasurer furnished a false statement, the surety would have been relieved, was not decided.

The court in its opinion in this case spoke as follows:

"It is not improbable that the surety was misled by Godschall's falsehood. But the question still remains, must the county suffer by his untruthfulness? There is a clear distinction running through all the cases as to how far the conduct of public officers will affect the public, and to what extent declarations by an agent or individual or private corporation will affect his principal. An illustration of the former will be found clearly defined in United States *v.* Kirkpatrick, 9 Whea. 720; and of the latter in Lauer Brewing Company *v.* Riley, 195 Pa. 449. The laxity of a public officer in the performance of his duty, his conduct not in the line of his official duty, cannot be permitted on grounds of public policy to prejudice the public. Assume, for the sake of argument, that the county treasurer was the representative of the county, though that is at least doubtful, then comes the question, in what particular does he represent it? Clearly only in those which pertain to his office. His morals outside of his official acts may be reprehensible, and be the indirect cause of loss to others; but the public who elected or appointed him are not responsible. So here the public is not responsible for the untruthfulness

[1] 205 Pa. St. 372; 54 Atl. 1034.

of their officer in a matter where the public imposed upon him the performance of no duty. In this state, under the act of 1834, the county treasurer is to faithfully perform the duties of his office, is to keep a just account of all county moneys that may come into his hands, deliver to his successor all books, documents and papers belonging to the office, and pay over to him any balance of county funds in his hands. There is no express or implied direction that he shall answer truthfully all questions put to him by third persons. He must keep correctly all official books and accounts; they will then necessarily show the exact financial relation to the county of those subordinates and others who have official transactions with the county treasurer. These accounts are public accounts, open to the public and accessible to all. Any third person desiring information can examine the accounts himself, or employ an agent or attorney to do so and report to him. There is no official duty on the treasurer to examine and make such report; if he do so at the request of a third person, he becomes the mere agent of that person to do what he is not officially obliged to do, and whether he performs the act well or ill, it is something with which the public has no concern and is in no way responsible.

"In his official acts he must tell the truth, or the public suffers; for instance, if it is his duty to receive the unpaid taxes or unseated lands and receipt therefor; if a taxpayer requests a statement of the amount of such taxes and pays according to the statement, although the amount be less than the real amount assessed, no valid sale of the land can be made in default of payment for the excess above the statement. But this is an official act and the public suffers because of the untruthfulness of its officer. But by appointing Godschall treasurer, the public did not constitute him a 'bureau of information' for the accommodation of all persons who chose to ask questions of him. We are of opinion the surety company had no legal right to ask these questions, and when it did there was no official duty on the part of the officer to answer them; when he chose to do so he was the mere agent of the company, just as any other person would have been of whom it might have made the same request."[1]

§ 167. **Discharge of Liability by Breach of Conditions.** — Various conditions of official insurance bonds, relative to

[1] See also the following cases: Am. Bond. & Tr. Co. *v.* Milestead, 102 Va. 847; 47 S. E. 853; Independent School District *v.* Hubbard and the Am. Sur. Co., 110 Ia. 58; 81 N. W. 241; Sup. Coun. Cath. K. of A. *v.* F. & C. Co. of N. Y., 63 Fed. 48; 11 C. C. A. 96; Columbian Exposition Salvage Co. *v.* Union Cas. Co. of St. Louis, 123 Ill. App. Ct. 245.

attachment and duration of liability, payment of premiums, etc., have already been considered in preceding sections of this chapter.[1] Most of these are conditions precedent to the creation of liability thereunder. There still remain some few "conditions subsequent," which have not yet received any extended consideration herein. The Nebraska Supreme Court recently had occasion to consider the legal effect of a condition in an official fidelity bond limiting the liability of the insurer thereunder to such defaults of the "risk" as should be discovered within six months from the expiration of the time covered by the bond. The court in its opinion held that the validity of such condition depended upon the nature of the position held by the "risk" which it stated governed the character of the bond. Thus, if the instrument was not held to be an official fidelity bond, then the condition would be valid. On the other hand, if it was construed to be an official bond (as the court did in that case) then the statutory provisions entered into and became a part of the contract and imposed upon the surety all the statutory obligations incident to the contract.[2]

The same rule was laid down in Mayor, etc., of Brunswick *v.* Harvey, *et al.*[3] In this case the court held that the bond given by the surety company should be construed not as a statutory official fidelity bond, but as a voluntary bond. Therefore, where it is stipulated therein that the liability of the surety company issuing the same should be limited to such losses as should occur during the continuance of the bond, or any renewal thereof, or as should be discovered during the said continuance or within six months thereafter, or within six months from the death or retirement of the "risk" from the services of the insured, and that upon the issuance by the surety company of any subsequent bond guaranteeing the fidelity of the "risk" named in the original bond, the liability of the latter should cease and determine, so that no two bonds should be

[1] See §§ 141–154.

[2] U. S. Fid. & Guar. Co. *v.* McLaughlin, *et al.* (Neb.) ; 107 N. W. 597.

[3] 114 Ga. 733; 40 S. E. 754.

operative at the same time, then under such circumstances the surety company cannot be held liable under the original bond for any loss not discovered until more than six months after the expiration of such bond, even though such loss was discovered within six months from the dismissal of the employee, and during the continuance of one of the subsequent bonds.

In a recent Kentucky case[1] the sheriff, after discovering the default of one of his deputies, gave notice to the local agent of the surety company which had furnished an official fidelity bond for such deputy and from whom notice was transmitted to the surety company's home office, in response to which notice an inspector was sent to examine the accounts of the "risk." Upon showing the existence of a deficit in the "risk's" accounts, it was held that the provision of the bond so issued, requiring notice to the surety company immediately after the discovery of default, was valid, but that the act of the surety company in sending an inspector to examine the "risk's" accounts constituted a valid waiver of the aforesaid condition of the bond.

It was held in Fohs *v.* Rain[2] that, as against the state, the insurer cannot avail itself of the defence that it is relieved from liability on an official bond issued by it by reason of a change in the title of the "risk's" office. It goes without saying that one of the implied conditions of an official bond is that the liability of the surety thereon abates by the death of the "risk."[3]

It may also be said that the doctrine of waiver, as it exists in private fidelity insurance, is equally applicable to official bonds.[4]

§ 168. **The Insurer's Liability, to be Enforceable, must be one for which the "Risk" is Liable to the Insured.** — The prin-

[1] U. S. Fid. & Guar. Co. *v.* Paxton, 32 Ky. L. Rep. 707; 106 S. W. 841.

[2] 79 N. Y. Sup. 892; 39 N. Y. Mis. 316.

[3] Wallace *v.* McPherson, 139 N. C. 297; 50 S. E. 897.

[4] U. S. Fid. & Guar. Co. *v.* Paxton, 32 Ky. L. Rep. 707; 106 S. W. 841; see generally Prescott Nat. Bank *v.* Head (Ariz.) ; 90 Pac. 328.

ciple above stated is, in fact, a declaration of the rule which pervades all departments of insurance law, to the effect that to enable the insured to recover from the insurer under a policy of insurance, the former must have an insurable interest in order to entitle him to recover under the policy. The principle here stated was asserted by the federal court of appeals in National Surety Company *v.* City Savings Bank.[1] The court in that case stated that it was an elementary rule that no liability could exist in favor of the insured against the insurer on an official fidelity bond, unless a coexisting liability could be asserted in favor of the insured against the "risk" named in the bond.[2]

§ 169. **Discharge of Liability by Alteration in Contract.** — It appears to be an implied condition of official fidelity bonds that the parties to a bond for the faithful discharge of the duties of an office necessarily contemplate and intend to guarantee thereby not only the faithful discharge of the duties of the office as they exist at the time the bond is given, but that they further contemplate and intend to guarantee the faithful discharge of additional duties imposed upon the "risk" by subsequent legislation or by the authority of his official superiors, provided such duties are within the scope of his office and are germane thereto. The parties, however, to such a bond cannot be held to intend to guarantee the discharge of duties not within the scope of the "risk's" office, unconnected with its business or foreign to the duties of the office, as the same exist at the time of the execution of the bond.[3]

§ 170. **Notice and Proof of Loss.** — Where the bond provides for notice and proof of loss as a condition precedent to the enforcement of the surety company's liability on an official

[1] 156 Fed. 21.

[2] See also to the same effect Fid. & Dep. Co. *v.* Beale, 102 Va. 295; 46 S. E. 307; U. S. *v.* Am. Sur. Co., 155 Fed. 941; Stevens *v.* Carroll, 131 Ia. 170; McMullin *v.* Winfield Bldg. & Loan Ass., 64 Kan. 298; 67 Pac. 892; Nat. Sur. Co. *v.* City Sav. Bank, 156 Fed. 21; Moser *v.* Bankers Sur. Co., *et al.*, 95 N. Y. Sup. 607; 109 App. Div. 172.

[3] U. S. Sur. Co. *v.* U. S., 129 Fed. 70; Prescott Nat. Bank *v.* Head (Ariz.) ; 90 Pac. 328.

bond, such a condition must be substantially complied with unless the same is waived by the insurer.[1]

A somewhat peculiar holding in this immediate connection was made in the case of United States Fidelity and Guaranty Company *v.* United States,[2] which was, that a statute which provides that the presentation by an Indian agent of vouchers, accounts and claims, containing material misrepresentations of fact in regard to the amounts due and paid, shall not constitute an account, makes it the duty of the county officers of the government to reject such vouchers, but does not impose a penalty nor render an action to recover the indebtedness resulting from the rejection of such accounts one for the recovery of a penalty, but merely prescribes a statutory rule of accounting which becomes a part of the contract of a surety for the Indian agent to which his obligation is subject, and it is not a defence to such an action on an agent's bond that the vouchers so rejected contained correct and true items of expenditures, the agent having the right on their rejection to furnish true vouchers for all items for which he was entitled to credit. That the bond required from and given by the Indian agent contained provisions not required by any statutory provisions does not affect its validity where its provisions were not in violation of law, and it was entered into voluntarily by both principal and surety, the president and secretary of the interior being authorized by statute[3] to prescribe the character of such a bond both as to its penalty and the nature and condition of its obligation.

§ 171. **Discharge of Liability by Settlement of Loss.** — An instructive case relative to the discharge of liability by settlement of loss is that of Walker County *v.* Fidelity and Deposit Company.[4] The facts in that case briefly stated are as follows:

[1] See U. S. Fid. & Guar. Co. *v.* Paxton, 32 Ky. L. Rep. 707; 106 S. W. 841; Bowebraker *v.* Hunt (Ariz.) ; 89 Pac. 544; Bufford *v.* Chambers, *et al.* (Ala. ; 42 Sou. 597.)

[2] 150 Fed. 550.

[3] Rev. Stat. 465, U. S. Comp. St. 1901, p. 264; and § 2057.

[4] 170 Fed. 851.

The Alabama statute provided that a collector of taxes may retain his commissions when he makes payment into the state treasury. They also provided that he must, on or before January 10 and April 10 in each year, account to the auditor under oath for the amount of taxes, etc., and on such accounting shall be allowed by the auditor the amount then due for commissions, etc. It was held both in view of the statutes and independent thereof, that a defaulting tax collector was not entitled to commissions on money which he failed to pay over, and his surety could not claim a credit therefor.

The Alabama statute further provided that a tax collector should, within five days after each monthly report, pay over taxes collected and provided for a final settlement in July and required payment of the balance found due. It was held, in view thereof, that a collector's failure to pay over a monthly collection continued the obligation to pay thereafter particularly as to his final returns in July; and his sureties on a bond executed in the following month were equally liable therefor as for a subsequent default; and even if the obligation did not continue, his use of money collected subsequent to the giving of the bond to make good a delinquency which occurred prior thereto was a misapplication for which the surety was liable.

"On general principles," it was said, "a defaulting tax collector ought not to be entitled to commissions on the amounts he has collected from tax payers and failed to pay over to the proper authorities. He had not performed the full work for which the commissions were intended to pay, and he is an unfaithful trustee. The sureties on a defaulting tax collector's bonds who refuse to pay up the defalcation and compel litigation ought to be entitled to credit for the amount of commissions or any sum the tax collector has collected. The public ought not to be compelled to pay the commissions for collecting the taxes, and at the same time be at the expense of litigation with the sureties on the defaulting tax collector's bond to recover the same money."

"We think," observed the court, "that sureties are liable for all moneys received after their bond was given, and that they cannot relieve themselves from this liability by showing that their principal used moneys, or a portion thereof, to satisfy past delinquencies to the state. To permit the acts of the 'risk' in that respect to have the effect of an exoneration of his sureties from responsibility, would, under the circumstances, be to allow them to make a shield and defence of the fraudulent contract of an officer whose honest and faithful discharge of the duties of his office they had guaranteed."

It was further held that the failure to pay over the moneys monthly within five days did not make the risk an absolute defaulter for the same by the failure to do so, as there was a continual incumbent duty upon him as tax collector to pay it over.[1]

In an Iowa case plaintiff furnished defendant's official bond on the express condition that he would indemnify it against all losses, counsel fees, and expenses of every kind which it should have sustained or incurred by reason of its having executed the bond. It was held that plaintiff was entitled, in the absence of bad faith, to recover for fees of counsel employed by it in a suit brought against it and defendant on the bond, though it had employed competent counsel to represent them both and it notified it thereof.[2]

The United States may maintain an action against the surety of the bond of a letter carrier who has stolen letters for the value of the contents of the stolen letters where the contents of any single letter exceed $10 value, although the owners of the letters have made claim against the government for indemnity and nothing has been paid to them.[3]

Where in an action against the sureties of a sheriff on his bond as tax collector for a deficit in the collection of taxes, it was conceded that he had not previously received credit for certain claims payable out of the funds of prior years, which he in fact paid out of the tax of 1905 collected by him, his sureties were entitled to credit for such claims as against the amount of the sheriff's liability for that year.[4]

Report was made and recorded by the commissioner's bond by the fiscal court pursuant to Ky. Stat. 1903, § 41, to make a settlement with

[1] See also Fid. & Dep. Co. *v.* Mobile Co., 124 Ala. 144; 27 Sou. 386.

[2] U. S. Fid. & Guar. Co. *v.* Hittle, 121 Ia. 352; 96 N. W. 782.

[3] U. S. Sur. Co. *v.* U. S., 129 Fed. (70 C. C. A. 8th Cir.).

[4] Ætna Indemn. Co., *et al.* *v.* Lawrence Co. (Ky.) ; 107 S. W. 339.

the sheriff after he had absconded cannot be created as a settlement bonding on the sheriff and his duties.[1]

A settlement made by a county treasurer under Code 1887, § 882; Va. Code 1904, p. 408, requiring the treasurer at the July meeting of the Board of Supervisors, or soon thereafter as may be, to settle with the board his accounts, is only *prima facie* evidence of the balance in his hands, at the date of such settlement against the surety on his bond, conditioned that he should faithfully discharge the duties of his office, but not contained in the contract of indemnity.

Proceedings by notice and motion by a county treasurer to recover money alleged to be due the county from his predecessor may be enjoined by the surety of such predecessor and the surety permitted to make his defence in a court of equity, the case being a proper one for equitable cognizance, though the surety might be able to make its defence at law.[2]

§ 172. **Measure of Damages under Official Bonds.** — An interesting case on the measure of damages sustained by the insured under an official fidelity bond is that of Fidelity and Deposit Company of Maryland *v.* Commonwealth.[3] The court held that in an action on the official bond of a town marshal to recover damages for a false arrest and for assault and battery, that only compensatory damages can be recovered.

Where in an action against the sureties of a sheriff on his bond as tax collector for a devastavit in the collection of taxes, it was conceded that as he had not previously received credit for certain claims payable out of the levies of prior years, which he in fact paid out of the taxes of 1905, collected by him, his sureties were entitled to credit for such claims as against the amount of the sheriff's liability for that current year.[4]

While the penalty of the bond fixes the limit of liability of the surety at the time the liability arises, yet if the principal or surety failed to discharge that liability when it matures

[1] Fid. & Dep. Co. of Md. *v.* Logan Co. (Ky. Ct. of App.) ; 84 S. W. 341.

[2] U. S. Fid. & Guar. Co. *v.* Jordan, *et al.* (Va.) ; 58 S. E. 567; Commonwealth to the Use of Clarion County *v.* U. S. Fid. & Guar. Co. (Pa.) ; 69 Atl. 550.

[3] (Ky.) ; 93 S. W. 668.

[4] Ætna Indemn. Co. of Hartford, *et al.* *v.* Lawrence Co. (Ky.) ; 107 S. W. 339.

interest may be allowed on the amount from the time the liability arises, even if the amount of recovery shall exceed the penalty.[1]

Where an officer and agent misappropriates money entrusted to him and fraudulently conceals his defalcations, the statute will not begin to run until the discovery of the fraud and of the breach of the condition of the bond.[2]

[1] McMullin *v.* Winfield Bldg. & Loan Ass., 64 Kan. 298; 67 Pac. 892.
[2] *Idem.*

PART IV. — COMMERCIAL INSURANCE

CHAPTER XVI

CONTRACT INSURANCE

§ 173. **Commercial Insurance Defined and Discussed.** — Commercial insurance is an agreement whereby for an agreed premium, one party, termed the insurer, agrees to indemnify another, termed the insured, in a stipulated amount against losses sustained by the latter through breaches of contract on the part of a third party — hereinafter referred to as the "risk" — sustaining a non-fiduciary contractual relationship to the insured.[1] The general subject of commercial insurance may be divided into three classes, — that of "contract," "credit" and "title" insurances.

Each of these will be given separate consideration.

Commercial insurance may be differentiated from fidelity insurance through the absence of that distinctive moral element arising from the existence of a fiduciary relationship between the insured and the "risk." On the other hand, it is easily distinguishable from judicial insurance in that it has no relationship whatever to the administration of justice by the courts — from which fact judicial insurance takes its name.

The wonderful extension and development of business methods, coupled with the increasing tendency to make use of the surety company bond in preference to that furnished by gratuitous bondsmen, has brought commercial insurance to a par with fidelity insurance in the degree of importance

[1] See Cowles *v.* U. S. Fid. & Guar. Co., 37 Wash. 695; 79 Pac. 1134.

to be attached to it. In the words of the Iowa Supreme Court in Van Buren Surety Company *v.* American Surety Company,[1] "the business of corporations authorized to insure the performance of contracts for profit partakes largely of the nature of insurance, and as to which the rules governing insurance are generally applicable."[2]

§ 174. **Contract Insurance Defined and Discussed.**—Contract insurance is that branch of commercial insurance, whereby for an agreed premium the insurer agrees to indemnify the insured in a designated amount against loss or damage arising through a failure on the part of third parties to specifically perform contracts of a non-fiduciary character, entered into by the latter with the "insured." The third parties here referred to constitute the "risks" in such insurance contracts and sustain to the insured the relationship of contractors to contractees.[3] The agreements formulated for the purpose of evidencing the contracts thus entered into are in common parlance almost universally referred to as "indemnity bonds." The best known of such instruments are those furnished for contractors, common carriers, warehousemen, apprentices, shipowners, importers, depositaries, public bidders, owners of lost instruments, bankers, etc. The nature of the obligation here referred to while in form a simple contract of indemnity is in legal effect a contract of insurance.[4]

[1] (Ia.) ; 115 N. W. 241.

[2] See also Cowles *v.* U. S. Fid. & Guar. Co., 37 Wash. 695; 79 Pac. 1134.

[3] First Nat. Bank *v.* School Dist. No. 1 (Neb.) ; 110 N. W. 349.

[4] Union Tr. Co. *v.* Cit. Tr. & Sur. Co., 185 Pa. St. 217; 39 Atl. 886; Field *v.* Cit. Ins. Co., 11 Mo. 50; Stillwell *v.* Commercial Ins. Co., 2 Mo. App. 22; German Am. Tit. & Tr. Co. *v.* Cit. Tr. & Sur. Co., 190 Penn. 247; 42 Atl. 682; Cowles *v.* U. S. Fid. & Guar. Co., 37 Wash. 695; 79 Pac. 1134; Dane *v.* Mortgage Ins. Co. (1894), 1 Q. B. 254; Raymond *v.* Talman, *et al.*, 91 N. Y. Sup. 670; 100 App. Div. 400; Van Buren Sur. Co. *v.* Am. Sur. Co. (Ia.) ; 115 N. W. 241; *in re* Denton's Es. Lic. Ins. Corp. & Guar. Co., Ltd. *v.* Denton, L. R. 1903, 2 Ch. 670; City of Milbank *v.* Western Sur. Co. (S. D.) ; 111 N. W. 561; First Nat. Bank *v.* School Dist. No. 1, Neb. ; 110 N. W. 349; Parker Co. *v.* Kansas City, 73 Kan. 722; 85 Pac. 781.

On this subject the court in Ausplund *v.* Ætna Indemnity Company[1] spoke as follows:

> "Though the contractual relation of a corporate suretyship to indemnify a party against loss occasioned by its principal's breach of an agreement is precisely the same as if the contract had been signed by a private party without compensation, the agreement is nevertheless like an insurance contract in that it affords remuneration for damages caused by negligence, bad faith, and the breach of an agreement."

Such contracts are never to be regarded as a guarantee of the ability of the "risk" to perform the contract which is the subject-matter of the insurance, according to its terms, nor is it a guarantee of the "risk's" solvency. It is to be regarded as a guarantee that the "risk" will faithfully fulfil the obligations of his contract with the insured.[2]

It is impossible to emphasize too strongly the necessity of constantly bearing in mind the fact, that the great majority of contract insurance bonds are so drawn as to provide a twofold indemnity. The first of these is that against failure on the part of the "risk" to perform his contract with the insured in strict accordance with the plans and specifications agreed upon between them. The second form of indemnity here referred to, is that providing for the settlement by the "risk" of all claims for labor and material furnished to him by his sub-contractors for the use and benefit of the insured. While there would be of course no direct liability on the part of the insured to pay such claims in case the "risk" failed to do so, nevertheless the former may be indirectly compelled to pay them through the operation of "the labor and material" lien laws of the several states. Sometimes the right is given under such circumstances (either by statute or by express provision in the bond itself) to labor and material men to sue directly on the contract insurance bond, to recover the amount of their claims.

[1] 47 Ore. 10; 81 Pac. 577.

[2] Union Tr. Co. *v.* Cit. Tr. & Sur. Co., 185 Pa. St. 217; 39 Atl. 886; see also Central Tr. Co. *v.* Louisville Tr. Co., 100 Fed. 545; 40 C. C. A. 530.

The Pennsylvania Supreme Court had before it in Equitable Trust Company *v.* National Surety Company [1] the question as to whether a contract insurance bond was one of indemnity or of guaranty. In this case a bond had been given conditioned that the surety should at all times thereafter, during the continuance of the bond, indemnify the insured against all damages and expenses incurred on account of any work or labor or material furnished for the erection of certain buildings and should furnish the material and labor necessary to complete the construction of such buildings free and clear of mechanics' liens and should comply with all the terms of the contract and perform the covenants therein contained. The court, holding that in the light of the first clause of the foregoing conditions, the bond was one of indemnity, and as to the second, it was a guarantee to furnish material to complete the work, spoke as follows:

"The present action is not founded on a policy of title insurance and the contract relied on is not necessarily one of indemnity. This suit is based on the bond and the conditions thereof are whatever the parties choose to make them. It is true they could have made the bond one of indemnity. It is equally true that they could make it one of guaranty, either or both. There can be no doubt that the first clause of the condition of the bond in question is an indemnity; but it is just as clear that the second clause is one of guarantee to furnish the materials and complete the work. The learned counsel for appellant contend however that the general import of the contract is one of indemnity, and that all of the words used therein should be construed to be in harmony with and subservient to the general purpose of the bond. As a general rule the correctness of this proposition may be conceded, but it is not applicable to the facts of this case. This rule when applied should be in aid of the intention of the parties and not to defeat their purpose. The covenants of the bond are the guide to the court. They should be construed to mean what the parties intended, in so far as that intention can be ascertained by the words used. The distinction between a contract of indemnity and one of guaranty is pointed out in Weightman *v.* National Trust Company,[2] where Mr. Justice Potter among other things said: 'The distinction between the two agreements is simply that between an affirma-

[1] 214 Pa. 159; 63 Atl. 699.

[2] 208 Pa. St. 449; 57 Atl. 879.

tive covenant for a specific thing, and one of indemnity against damage by reason of the non-performance of the thing specified.'

"There is ample authority to support this proposition that a bond may have two separate and distinct conditions, and that upon a breach of one condition an action will lie. Also that when the condition of the bond is an undertaking to do a particular thing, failure to do that thing is a breach, upon the happening of which a cause of action arises."

In the foregoing case reference is made to the case of Weightman *v.* National Trust Company.[1] In the case just referred to the owner of land had entered into an agreement to erect certain buildings and make certain street improvements thereon, in a consideration of a loan of money to be secured by a mortgage on the land. The owner had given to the mortgagee a bond with a trust company as surety, according to the terms of which the latter agreed to save the mortgagee harmless on account of any insufficiency in his mortgage security resulting from failure by the owner to complete the contract. The court held that the "surety company" would not be held liable for damages on its bond by reason of the failure of the owner to complete certain street improvements where there was no evidence to show that the mortgagee suffered any material loss or damage from the failure of the owner to complete the work. The mere fact that the mortgagee bid in the property at sheriff's sale for a sum less than the amount of the mortgage debt was not conclusive evidence of loss. In the foregoing case the court held that the distinction between the two agreements is that which exists between an affirmative covenant for a specific thing and one of indemnity against damage by reason of the non-performance of the thing specified. The court held in effect that the objects of both agreements may have been substantially the same, in that both were intended to save the insured from loss, but that the legal effect of the two agreements was essentially different.

In connection with the furnishing of bonds to the United

[1] 208 Pa. St. 449; 57 Atl. 879.

States government by "surety companies" pursuant to statute, the following may be said: That such bonds constitute in effect two separate instruments; to wit, one given to the United States to insure the faithful performance by the contractor of his obligations to the government, and the second given to the United States as a mere nominal party for the purpose of insuring the faithful discharge of the contractor's obligations to his sub-contractor. It is the "usual penal bond with good and sufficient sureties" that is given to the United States. But to this undertaking is added the additional obligation that such contractor or contractors shall promptly make payment to all persons supplying him or them labor or materials in the prosecution of the work provided for in such contract.[1]

Again it should be carefully noted that every case involving a contract insurance policy brings before the court for review two separate and distinct undertakings. To the first contract (which is the contract the faithful performance of which the second contract is given to secure) the "risk" and the insured are alone parties. To the second contract the insurer, the insured, and the "risk" are the parties. It is the first contract, which may be here termed the "construction contract" that creates and defines the obligation and liability respectively of the insured and the insurer. This latter contract is thus made to assume an importance which it would not otherwise have, as determining the nature and scope of the duty whose performance is secured by the second contract (the contract insurance bond), and in the determination of any question as to whether or not there has been any breach of the conditions of the contract insurance bond, during the life of the construction contract.[2]

Finally a word might be said at this time as to the general form of policies of contract insurance as written by the

[1] U. S. to the Use of Phenix Iron Co. *v.* C. B. C. Co., 152 Fed. 559.

[2] New Haven *v.* Nat. Steam Economizer Co., 79 Conn. 482; 65 Atl. 959; City of Madison *v.* A. S. E. Co., 118 Wis. 480; 95 N. W. 1097.

various "surety companies." In this connection the words of a writer in the *Indemnitor* (a publication issued by a guaranty insurance company) are reproduced here as follows:

"There seems to be considerable variance in the forms of so-called 'contract bonds' in use by different guaranty companies. Of course, the forms in use for the United States Government or municipal contracts are generally perscribed by law or are prepared by the different departments or municipal officers to whom they are given. For private contracts, some of the guaranty companies have been in the habit of inserting various conditions attempting to limit or define the liability of the surety. Some of these conditions provide, for example, that no liability shall attach to the surety unless, in the event of any default on the part of the principal, the obligee shall promptly within a certain specified number of days after the occurrence of such default, deliver a written statement to the surety of the principal facts showing such default. Another common condition provides for the subrogation of the surety to all the rights and property of the principal, etc. Other conditions also exempt the surety from liability for damages caused by the act of God, or public enemies, or mobs, or riots, or strikes; and attempt to specify that the surety shall not be subject to any suit instituted under the bond later than six months after the work is supposed to have been completed.

"It has been found by experience that the simpler the form of a contract bond and the fewer the conditions contained in it, attempting to limit or define the liability of the surety, the less chance there is for misunderstanding and confusion as to its meaning and of litigation arising therefrom. All conditions limiting or affecting the liability of the surety ought to apply also to the principal on the bond, and for this reason it is thought that all such conditions are more properly to be contained in the contract itself, rather than in the bond accompanying the same. If this is done, there is less chance of such conditions conflicting with the terms of the contract.

"A 'contract bond' or obligation guaranteeing the performance of a contract, either public or private, for the performance of work and labor or for the furnishing of supplies, ought to conform as closely as possible to the definition of contract insurance as given by Mr. Frost in his work 'The Law of Guaranty Insurance,' § 134, as follows: 'Contract insurance is that branch of commercial insurance whereby for an agreed premium the insurer agrees to indemnify the insured in a designated amount against loss or damage arising through the failure

on the part of third parties to specifically perform contracts of a non-fiduciary character entered into by the latter with the insured.'

"We think it is the consensus of opinion of those who have had long experience in this branch of the surety business that the simplest form for a contract bond is the best, and that such a bond should contain: First, the ordinary clause binding the principal and surety in a certain amount to a certain obligee; second, a paragraph or paragraphs reciting and briefly describing the contract which the bond accompanies, and its terms; and third, a clause containing the condition of the bond, which should be merely that the principal in the bond will faithfully perform his part of the contract."

§ 175. **Validity of Contract Insurance.** — It may be asserted with entire confidence that there can be no doubt at this late date as to the validity of contract insurance.[1]

The Supreme Court of Kansas in a recent case [2] had occasion to pass upon the validity of a statute requiring city contractors to furnish surety company bonds, in preference to private bonds, in the following language:

"A further objection is incidentally made to the statute because of a provision that all persons contracting with the city to make street improvements shall be required to secure the faithful performance of their contracts by the giving of bonds executed by some 'surety company' authorized to do business in the state. It is argued that this tends to the creation of a monopoly in the making of such bonds. The writing of such bonds is a form of insurance. There are reasons why the bond given by a corporation over which the statute exercises certain control might be deemed preferable to any executed only by individuals. It would be competent for the legislature to authorize the municipality in its discretion to execute such a bond; that is, one signed by a surety company, and it is clearly competent for it

[1] See Am. Sur. Co. *v.* Raeder, *et al.*, 15 O. Cir. Ct. 47; Am. Sur. Co., *et al. v.* Lauber, *et al.*, 22 Ind. App. 326; 53 N. E. 793; Samuels *v.* F. & C. Co. of N. Y., 1 N. Y. Sup. 850; 19 Hun. 122; Am. Sur. Co. of N. Y. *v.* San Antonio Loan & Tr. Co. (Tex.) ; 95 S. W. 367; Shaughnessy, *et al. v.* Am. Sur. Co. of N. Y., 138 Cal. 543; 69 Pac. 250; Davis Belan & Co. *v.* Nat. Sur. Co. of N. Y., 139 Cal. 223; 72 Pac. 1001; Home Sav. & Tr. Co. *v.* Fid. & Dep. Co. of Md., 115 Ia. 353; 88 N. W. 831; Kansas City Hydraulic Press Brick Co. *v.* Nat. Sur. Co., 157 Fed. 620; McGarry, *et al. v.* Seitz, *et al.*, 129 Ga. 296; 58 S. E. 856; U. S. to the Use of Standard Oil Co. *v.* City Tr., Safe Dep. Co., 21 App. Dis. Col. 369.

[2] Parker Co. *v.* Kansas City, 73 Kan. 722; 85 Pac. 781.

to exercise its own judgment in the matter in the first instance and require that character of security."

§ 176. **Insurable Interest in Contract Insurance.** — The courts have not at all times taken due cognizance of the necessity of ascertaining whether the insured in a policy of contract insurance had what is known as an "insurable interest" at the time the policy was issued. To entitle the insured to recover from the insurer on a contract insurance bond, the former must have some direct pecuniary interest in the faithful performance of the contract for which the bond is given to secure, commensurate with that which he seeks to enforce against the insurer.[1]

The true test as to the existence of the necessary insurable interest in the insured is whether the latter has an enforceable claim in his favor against the "risk" named in the bond based upon the same state of facts as the claim asserted by such insured against the insurer.[2] The basis of the foregoing principle may be found in the recognition on the part of the courts that the insurer is subrogated to all the rights of the insured as against the "risk" named in the contract bond. In view of this last statement it is clearly apparent that were the insurer to settle a claim asserted against it by the insured, which did not have for its basis a co-existing liability of the "risk" (named in such bond) to the insured, that then the substantial benefit to be derived by the insurer from the application of the principle of subrogation already referred to would be valueless.[3]

The insurer which has issued a policy of contract insur-

[1] Folkes *v.* Tradesmen's Tr. & Sav. Fund Co., 201 Pa. 583; 57 Atl. 379; U. S. to Use of, etc. *v.* Merc. Tr. Co. of Pittsburg, 213 Pa. 411; 62 Atl. 1062; City of St. Louis *v.* F. H. Wright Cons. Co., *et al.*, 202 Mo. 451; 101 S. W. 6; Pac. Bridge Co. *v.* U. S. Fid. & Guar. Co., *et al.*, 33 Wash. 47; 73 Pac. 772.

[2] See Westcott *v.* Fid. & Dep. Co., 84 N. Y. Sup. 731; P. B.

[3] Henningsen *v.* U. S. Fid. & Guar. Co., 208 U. S. 404; Ausplund *v.* Ætna Indemn. Co., 47 Ore. 10; 81 Pac. 577; U. S. Fid. & Dep. Co. *v.* Schelper, *et al.*, Tex. ; 83 S. W. 871.

ance conditioned upon the due fulfilment by its "risk" designated therein of a certain contract entered into between such "risk" and the insured, has the undoubted right to insist that its liability shall be measured and determined by the identical contract, the performance of which it has guaranteed.[1]

A careful reading of the cases will serve to show that only under two possible situations is there any difficulty in ascertaining whether the party seeking to enforce the insurer's liability under a contract insurance policy or bond possesses the requisite insurable interest. The first of these arises where the insured assigns his interest in the policy to a third party before the incurrence of liability thereunder, and the assignee attempts to enforce an alleged liability under the policy in his own behalf. The other case is where parties who are not named as the insured in the policy or bond, nevertheless seek to enforce the liability of the insurer thereunder on the theory that the policy was taken out by another (the insured) nominally for his benefit, but in reality for theirs. Both of these cases will now be taken up for separate consideration under the following heads:

(A) Is a Contract Insurance Bond Assignable Prior to the Incurrence of Liability thereunder?

(B) Who are the Lawful Beneficiaries under a Contract Insurance Bond?

§ 177. **Is a Contract Insurance Bond Assignable Prior to the Incurrence of Liability thereunder?** — Cases will be found adopting the principle that the insured may lawfully assign his interest in the bond prior to the incurrence of liability thereunder, and that his assignee may recover thereon in case of default on the part of the "risk" named therein.[2]

[1] New Haven *v.* Nat. Steam Economizer Co., 79 Conn. 482; 65 Atl. 959.

[2] See Am. Bond. & Tr. Co. *v.* B. & O. S. W. Ry. Co., 124 Fed. 866; Zane, *et al.* *v.* City Tr. Co., 117 Fed. 814; Cowles *v.* U. S. Fid. & Guar. Co., 32 Wash. 120; 72 Pac. 1032; U. S. to Use of Merc. Tr. Co., 213 Pa. 411; 62 Atl. 1062.

Such decisions do not appeal to one as being in accordance with well settled principles of insurance law, and we doubt as to their being followed in this country to any great extent. In fairness, however, to the courts which render them, we prefer before passing on to a statement of the true rule, as we conceive it to be, to give the following excerpt from the opinion of the court in American Bonding and Trust Company *v.* Baltimore and Ohio Southwestern Railway Company.[1]

"It has been said that the original of the rule that the benefit of the contract, *i.e.*, the right of one party thereto to have the other perform an obligation on his part arising therefrom, could not be assigned at common law so as to enable the assignee to sue in his own name for a breach thereof, was attributed by Coke to the 'esteem and policy of the founders of our law' in discouraging litigation. In opposition to this it may be said that there can be little or no doubt that it was in truth a consequence of the primitive view of a contract as creating a strictly personal obligation between the creditor and the debtor. According to this construction of a contract the relation created by it cannot be severed by either party thereto, the creditor or debtor, without the assent of the other. It is as impossible for either to substitute another in his place as it is for him to change any other term of the contract. This primitive view of a contract prevails no longer. The treatment by courts of equity of such assignments, the judicial cognizance by courts of law of the usage of merchants in relation to bills of exchange, rendering it a part of the common law, the passage of statutes making certain contracts assignable, the construction placed upon the statutes enacted in numerous jurisdictions requiring actions to be brought in the name of the real party in interest and the conception of such rights as property, and the possession thereof as ownership, account for its passing away. But notwithstanding this, it is still possible that a certain contract may create such a relation between the parties thereto — a relation that cannot be severed by the creditor assigning to another his right to have the debtor perform his obligation. It will do so, if it contains an express stipulation prohibiting such an assignment. . . .

"It will also do it if it is a bilateral contract and the counter obligation on the part of the creditor to the debtor is of such a nature that the reasonable inference therefrom is that it was the intention of the

[1] 124 Fed. 866.

parties that it should be performed by the creditor and no one else. Perhaps a more careful statement would be that in such a case the right cannot be assigned so as to compel the debtor to accept performance of that obligation from the assignee, and, if an attempt is made to so assign it, the assignment will be invalid.

"If the rule here goes no further than this, there is nothing in the existence of such a counter obligation to prevent an assignment by a creditor of his right after he has performed that obligation, and thus perfected his right or even before, if no attempt is made to shift the duty of performing it from himself to the assignee."

"There are decisions of the Supreme Court of the United States which are sufficient to furnish us with a rule as to the assignability by a creditor of his right to have the obligation of his debtor, arising out of a binding contract between them, which can be applied to this case in determining whether the guaranty bond in question here was assignable. That rule is, that such a right is assignable, unless there is something in the terms or nature of the contract, considered from the standpoint of the situation as it existed when the contract was made, that evidences that it was the intention of the parties thereto that it should not be assignable. For such a right to be assignable, absence of evidence that it should not be, is sufficient. If there is no evidence of such intention, it is to be presumed that it was the intention of the parties to the contract that it should be assignable, — *i.e.*, that the creditor could substitute another in his place in the right to the performance of the obligation by the debtor — and that in this way, and to this extent at least, the relation thereby created between them could be severed. If, on the other hand, there is evidence in the terms or the nature of the contract so considered, which evidences that it was within the contemplation and the intention of the parties that it should be assignable, so much the greater reason for holding that it was so."

Having so presented the reasoning of the court on the subject, it only remains to comment thereon.

The foregoing decision wholly loses sight of the fact that a contract bond issued by a " surety company " is a contract of insurance. As such it is not assignable without the consent of the insurer. In its very nature it is a personal contract, highly confidential in character, and the ordinary rules referred to in the decision, as applicable to questions relative

to the assignability of contracts, have not the slightest application.

An insurer always considers the "moral risks" as well as the other hazards of its adventure. It has a right to choose whom it will insure, and what "risks" it will decline. In so doing, it is acting wholly within its legal rights and therefore it should have the support of the law, when necessary, to protect any attempted infringements upon such rights. This the law wholly refuses to grant, when it permits the insurer in the first instance to select the parties to whom it is willing to issue its policy of contract insurance, and then proceeds to condone what is virtually a fraud on the insurer, by compelling it — through the medium of an assigned policy of contract insurance — to accept, against its will, another personality entirely in place of the original party insured.

That there shall be no change in the personality of the insured — either by assignment of the policy or otherwise — is one of the implied conditions of every policy of contract insurance.[1]

Thus in Folz *v.* Tradesmen's Trust and Savings Fund Company,[2] the court made the following holding: That parties are of the essence of a contract as much as the subject-matter, and in order that there may be *identity*, not only must the subject-matter be the same, but the parties must be the same who signed the bond, prescribing in its conditions the completion of a contract entered into between the principal in the bond and the insured, and which is of the essence of the condition that the contract should be completed by the party to the contract.

In Citizens Trust and Surety Company *v.* Howell,[3] the true rule is enunciated. In this case an action had been brought against the "surety company" on a bond given to secure the performance of a building contract. The insured assigned

[1] See *ante*, § 103; see also *post*, § 205; see also Friendly *v.* Nat. Sur. Co. (Wash.) ; 89 Pac. 177; Strandell *v.* Moran, *et al.* (Wash.) ; 95 Pac. 1106.

[2] 201 Pa. 583; 51 Atl. 379.

[3] 19 Pa. Sup. Ct. 258.

his interest in the bond to a third party. The court held that such assignment discharged the surety for the reason that the bond did not contain the words "successors and assigns," and that therefore the consent of the surety company issuing the bond was necessary to the validity of any assignment thereof. This decision represents the true rule which should govern in such cases.[1]

§ 178. **Who are the Lawful Beneficiaries under a Contract Insurance Bond?** — There is a close and logical connection between the doctrine of the necessity of the insured's possessing an insurable interest in the policy and the determination of the question as to who are the lawful beneficiaries thereof. For no one can become the beneficiary of a policy of contract insurance except with the consent of the insurer issuing the policy, and then only when he possesses what is deemed, in law, a proper insurable interest therein. It may be said that the attitude of the courts on the question now under discussion seems to depend upon the particular view they happen to take with reference to the right of third parties to sue for breach of contract entered into by others for their implied benefit.[2]

Frequently, in order to enforce liability, under bonds given by contractors, the familiar doctrine is invoked that if one person makes a promise to another for the benefit of a third, the latter may maintain an action upon it, although the consideration did not move from him. Upon this question and the application of the rule, or rather the exception to the general rule, that to sustain an action there must be privity of contract between the parties, the cases are discordant and not at all reconcilable. The English courts hold that where

[1] See *post*, § 205; see also Westcott *v.* Fid. & Dep. Co., 87 N. Y. App. Div. 497; U. S. Fid. & Guar. Co. *v.* City of Newark, (N. J.) ; 66 Atl. 904; Fid. & Dep. Co. *v.* U. S. to Use of Smoot, 20 D. C. 376; Hipwell *v.* Nat. Sur. Co., 130 Ia. 656; 105 N. W. 318; Cameron, *et al. v.* Barcus, *et al.*, 31 Tex. Civ. Ct. of App. 46; 71 S. W. 423; Strandell *v.* Moran, *et al.* (Wash.) ; 95 Pac. 1106.

[2] Am. Sur. Co. *v.* Raeder, *et al.*, 15 O. Cir. Ct. 47; Nat. Sur. Co. *v.* Foster Lumber Co. (Ind. App.) ; 85 N. E. 488.

two persons make a contract in which one of them promises to confer benefits upon a third person, the latter cannot sue on the contract either in law or in equity for the money or other benefit which it was promised he should receive. The English doctrine has been adopted in a few of the American states. However, in the greater number of American states, the so-called "American doctrine" prevails. This permits such party to recover such benefit in a suit brought in his own name. The doctrine, however, falls far short of being applicable to every contract made by one person with another, from the performance of which a third person shall derive a benefit. On the other hand, it is strictly limited to *contracts which have for their primary object and purpose the benefit of a third person and which were made for his direct benefit. He must be the party intended to be benefited.*[1]

It may be stated that at the present time the so-called "American doctrine," with the limitations referred to above, has been all but universally adopted in the United States.[2]

Any close investigation, looking towards the ascertainment of the parties for whose express or implied benefit the policies of contract insurance are issued, is certain to develop the fact

[1] Searles, *et al.* *v.* City of Flora, 225 Ill. 167; 80 N. E. 98; Quarries Co., Ltd. *v.* Fid. & Guar. Co., 78 Vt. 445; 63 Atl. 581; Lancaster *v.* Frecoln, 203 Pa. St. 640; 53 Atl. 508; Lodge of Elks *v.* Sarden, Ark. ; 111 S. W. 255; Nat. Sur. Co. *v.* Foster Lumber Co. (Ind. App.) ; 85 N. E. 488.

[2] U. S. *v.* Am. Sur. Co. of N. Y., 126 Fed. 810; U. S. to Use of Flaherty *v.* Am. Sur. Co., *et al.*, 127 Fed. 490; U. S. *v.* Am. Bond. & Tr. Co. of Baltimore City, 128 Fed. 414; Am. Sur. Co. *v.* U. S. of Am. for Use of Alexander Watt, 77 Ill. App. 106; City of Phila. to Use of Webster *v.* Harry C. Nichols, 214 Pa. 265; 63 Atl. 886; U. S. Fid. & Guar. Co. *v.* U. S. for the Benefit of Kenyon, 204 U. S. 349; U. S. *v.* Fid. & Dep. Co. of Md., *et al.*, 132 Fed. 82; Phila. to Use of Neil, 206 Pa. 333; 55 Atl. 1032; Pac. Bridge Co. *v.* U. S. Fid. & Guar. Co., *et al.*, 33 Wash. 47; 73 Pac. 772; Town of Gastonia, *et al.* *v.* McEntee-McPherson Eng. Co., 131 N. C. 363; 42 S. E. 858; Am. Bond. Co. of Baltimore *v.* Dickey, 74 Kan. 791; 88 Pac. 66; U. S. to Use of J. G. Strait & Son *v.* U. S. Fid. & Guar. Co., Vt. ; 66 Atl. 809; U. S. to Use of Stansted Granite Quarries Co. *v.* 78 Vt. 445; 63 Atl. 581; U. S. to the Use of Vt. Marble Co. *v.* Burgdorf, 13 D. C. App. 506; U. S. to Use of Bell *v.* Em. St. Sur. Co., 100 N. Y. Sup. 247.

that there are two lines of decisions in apparent, though not, it is believed, in real, opposition one to the other on this question. Speaking generally, it may be said that these two lines of decisions are represented respectively by the state courts, on the one hand, when construing bonds given under local statutes, and by the federal courts, on the other hand, when construing contract bonds furnished pursuant to the federal statute governing that subject.

The first of these lines of decisions here referred to is represented by the opinion of the Supreme Court of Wisconsin in the case of Electric Appliance Company *v.* United States Fidelity and Guaranty Company.[1] This case involved the construction of a policy of contract insurance issued upon the application of a contractor who had undertaken contract work for a city. Under the contract entered into between the city (the insured) and the contractor (the " risk "), it was provided that the latter should provide a policy not only securing to the city the faithful performance of the contract according to the specifications, but it was also provided that it should be drawn so as to secure the payment of all claims for material furnished or labor performed. The contractor furnished a policy which contained no specific clause providing for the payment by the insurer of labor and material claims. It was contended, however, that there was an implied right on the part of laborers and material-men to sue on the policy under the provisions of the original contract above referred to, on the theory that the laborer and material-men were the real parties in interest rather than the city, so far as the right of action thereon was concerned. The Supreme Court of Wisconsin, in denying this contention, laid down the rule that to entitle a third party to recover under a policy of contract insurance, in some way there must appear therein an intent to secure a benefit thereby to a third party; that as between the latter and the " risk " named in such policy there must be an existing and legally enforceable promise

[1] 110 Wis. 434; 85 N. W. 648.

which the court said did not exist in that case, owing to the fact that there was no privity of contract as between the "risk" and the material-man who was seeking to enforce the insurer's liability under the policy of contract insurance furnished. The court further held in this case that a party furnishing materials to a "risk" who had contracted to erect and deliver a lighting plant to a city cannot sue on a policy of contract insurance procured by said "risk" where it is clear that the policy was taken for the individual benefit of the insured, and without any intent to secure the claims of third parties.

The Alabama courts seem inclined to go nearly as far as those of Wisconsin in refusing to allow laborers and materialmen to sue on policies of contract insurance given under the circumstances above referred to. In addition to this, the courts there seem inclined very properly to add, as an additional test of liability, the question whether there exists, at the time the insurer's liability is sought to be enforced by third parties, a coexisting liability for the claims of such third parties, on the part of the "risk" to such third parties. In American Surety Company *v.* United States to the Use of Barrett,[1] it was held that under a policy of contract insurance the insurer was not liable for labor and material furnished to a subcontractor, since the contractor himself was not liable to the parties furnishing such labor and material. To sustain the contention of such parties absolutely, the court said, would be to impose a liability on the "risk" to the insured for a personal liability for goods sold to a third party, for which the "risk" therein was in no wise responsible.

In a recent Louisiana case that court had occasion to pass upon a contract of insurance bond issued by a surety company for the insured named in such bond. The latter recited the provisions of the building contract for the purpose of showing the conditions upon which the obligations of the insurer to

[1] 127 Ala. 349; 28 Sou. 664.

the insured should become void. In an attempt on the part of certain laborers and material-men to compel the insurer to make good to them the amount of their claims against the "risk" (the contractor) as an implied liability of such insurer under the bond, the court held that they could not recover thereon; this for the reason that the bond contained no express agreement to indemnify any one except the insured. "It was not intended," the court observed, "to benefit any one but the insured, and the benefit to result to him was made dependent upon the conditions named in the bond."[1] Before passing on to the second line of cases referred to above, it should be noted that there is a radical distinction to be observed in this immediate connection between bonds executed voluntarily for the benefit of owners of property and those required by statute to be executed for the protection of laborers and material-men. In the former case, all parties other than the insured himself are regarded as mere strangers or volunteers, and as such not entitled to the benefit of the contract insurance bond.[2] This for the reason that such bonds are in no sense statutory bonds, and therefore statutes giving a right of action on such bonds to other than the insured named therein cannot be read into the bond.[3] On the other hand, statutory bonds are primarily intended to give security to laborers and material-men in those cases where no liens are permitted to be filed, as in the case of public buildings.[4] In such cases the state or the United States is to be regarded merely as the nominal insured.[5] The liability of the insurer on such bonds is to be governed by the same

[1] S. B. & L. Co. *v.* La Sassier, *et al.*, 106 La. 389; 31 Sou. 7; see also Pac. Bridge Co. *v.* U. S. Fid. & Guar. Co., 33 Wash. 47; 73 Pac. 772.

[2] Herpolsheiner *v.* Hansell-Elcock Co., 141 Mich. 367; 104 N. W. 671; Hardison & Co. *v.* Yeaman, *et al.*, 115 Tenn. 639; 91 S. W. 1111.

[3] Hardison & Co. *v.* Yeaman, *et al.*, 115 Tenn. 639; 91 S. W. 1111.

[4] Fid. & Dep. Co. *v.* Parkinson, 68 Neb. 319; 94 N. W. 120.

[5] Hipwell *v.* Nat. Sur. Co., 130 Ia. 656; 105 N. W. 318; Am. Sur. Co. *v.* U. S. to Use of Watt, 77 Ill. App. 106.

liberal rules of construction as apply in the case of ordinary mechanics' liens.[1]

The second line of decisions referred to above refer exclusively to contract insurance bonds executed pursuant to statute. These are well illustrated by the case of United States to the Use of, etc. *v.* National Surety Company.[2] Here the United States court of appeals for the eighth circuit held that the contractors' bonds contemplated by the United States revised statutes[3] are intended "in the first place to secure to the government the faithful performance of all obligations which a contractor might assume towards it; and in the second place, to protect third persons from whom the contractor obtained materials or labor. Viewed in the latter aspect, the bond, by virtue of the operation of the statute, contained an agreement between the obligators therein that they shall be paid for whatever labor or materials that they may supply to enable the principal in the bond to execute his contract with the United States. The two agreements which the bond contains, the one for the benefit of the government, and the one for the benefit of third persons, are as

[1] U. S. to Use of Vt. Marble Co. *v.* Burgdorf, 13 D. C. App. 506; see to the same effect City of St. Louis *v.* G. H. Wright Con. Co., *et al.*, 202 Mo. 451; 101 S. W. 6; Penn Iron Co., Ltd. *v.* W. R. Trigg Co., *et al.*, 106 Va. 557; 56 S. E. 329; City of Phila. to Use of Webster *v.* Harry C. Nichols, 214 Pa. 265; 63 Atl. 886; Lancaster *v.* Frecoln, 203 Pa. St. 640; 53 Atl. 508; Fid. & Dep. Co. *v.* Parkinson, 68 Neb. 319; 94 N. W. 120; Crane Co. *v.* Ætna Indemn. Co., *et al.*, 43 Wash. 576; 86 Pac. 849; Union Guar. & Tr. Co. *v.* Robinson, 79 Fed. 420; 24 C. C. A. 650; Am. Sur. Co. *v.* Lawrenceville Cem. Co., 96 Fed. 25; 110 Fed. 717; Am. Sur. Co., *et al.* *v.* Lauber, *et al.*, 22 Ind. App. 326; 53 N. E. 793; Herrick *v.* Guarantor's Finance Co., 58 N. Y. App. Div. 30; Fewell *v.* Am. Sur. Co., *et al.*, 28 Sou. 755; (Miss.) ; Anderson *v.* Nat. Sur. Co., 196 Pa. St. 288; 46 Atl. Rep. 306; Nat. Sur. Co. *v.* T. B. T. Nat. Br. & Con. Co., 176 Ill. 156; 52 N. E. 938; see *contra*, Phila. *v.* Stewart, 198 Pa. 422; 48 Atl. 275; Am. Sur. Co. *v.* Thorn-Halliwell Cem. Co., 9 Kan. App. 8; 57 Pac. 237; Nat. Sur. Co. *v.* T. B. T. Nat. Br. & Con. Co., 176 Ill. 156; 52 N. E. 938; Am. Sur. Co. *v.* Raeder, *et al.*, 15 O. Cir. Ct. 47; Davis *v.* Fid. & Dep. Co. of Md., 78 N. Y. Sup. 336; 75 App. Div. 518.

[2] 92 Fed. 549; 34 C. C. A. 522.

[3] 28 U. S. Stat. 278, c. 280.

distinct as if they were contained in separate instruments, the government's name being used as obligee in the latter agreement merely as a matter of convenience."[1]

A somewhat similar view of the question was taken in the case of the American Surety Company *v.* Lawrenceville Cement Company.[2] The holding there was to the effect that these policies of contract insurance are intended, first, to secure the faithful performance of the contract entered into as between the insured and the "risk"; and secondly, to protect third persons from whom the "risk" may obtain labor and material in the performance of his contract with the insured. In this latter aspect the insured is to be considered as a voluntary trustee alike for its own interests and for the interests of third parties who are in turn made beneficiaries of the insurance. It was specifically held in this case that the clause with reference to the parties to be benefited by a contract insurance policy should be liberally construed. Under this rule it was said that the statute under which it is furnished is not to be construed strictly like mechanics' lien statutes, nor, on the other hand, should it be extended to claims for labor and materials, which only incidentally relate to the prosecution of the work, such as the construction or permanent improvement of the plant or equipment of the "risk" which are capable of use in other work, or to the ordinary claims of a public carrier for freight, for which the law gives a lien. But the foregoing limitation does not apply to those parties making incidental repairs to equipment or to parties who transport materials for short distances, and who, although having a lien, are not expected, in the usual course of business, to exact payment before delivery. This whole subject, in so far as it relates to contract insurance bonds executed pursuant to any statute of the United States, was fully considered by the United States Supreme Court in the case of United States

[1] See also Union Guar. Tr. Co. *v.* Robinson, 79 Fed. 420; 24 C. C. A. 650; Am. Sur. Co. *v.* U. S. to the Use of Melton Hardware Co., 76 Miss. 289; 24 Sou. 388; Fewell *v.* Am. Sur. Co., 28 Sou. 755.

[2] 96 Fed. 25; 110 Fed. 717.

to the Use of Hill *v.* American Surety Company.[1] In this case the court spoke as follows:

"Labor and materials used in the prosecution of a public work, whether furnished under the contract directly to the contractor, must be deemed within the obligation of a surety company under a bond executed pursuant to the act of August 13, 1894,[2] conditioned for the prompt payment by the contractor to all persons supplying it labor or materials, in the prosecution of the work provided for in said contract, in view of the manifest purpose of that statute to protect those whose labor or material has contributed to the prosecution of the work.

"In considering the statute and determining the scope of the bond, divergent views have been urged upon the court. Upon the one hand, it is insisted that the bond is to be strictly construed and a recovery limited to those who have furnished material or labor directly to the contractor; and, upon the other, that a more liberal construction be given, and a recovery permitted to those who have furnished labor and materials which have been used in the prosecution of the work, whether furnished under the contract directly to the contractor or to a subcontractor.

"This statute was before this court in United States Fidelity and Guaranty Company *v.* Golden Pressed and Fire Brick Company,[3] and while the question whether surety companies which are such for compensation are entitled to the same strict construction of their rights and obligations as is accorded to private sureties who become such without reward or profit, was left open, it was nevertheless said: 'The rule of *strictissimi juris* is a stringent one, and is liable at times to work a practical injustice. It is one which ought not to be extended to contracts not within reason of the rule, particularly when the bond is underwritten by a corporation which has undertaken for a profit to insure the obligee against a failure of performance on the part of the principal obligor. Such a contract should be interpreted liberally in favor of the subcontractor, with a view of furthering the beneficent object of the statute. Of course, this rule would not extend to cases of fraud or unfair dealing on the part of the subcontractor, as was the case in United States Use of Heise *v.* American Bonding and Trust Company,[4] or to cases not otherwise within the scope of the undertaking.'

[1] 200 U. S. 437.

[2] 28 Stat. at L. 276, c. 280, U. S. Comp. Stat. 1901, p. 2523.

[3] 191 U. S. 416; 48 L. E. 242; 24 Sup. Ct. Rep. 142.

[4] 89 Fed. 921; 32 C. C. A. 420.

"And the rule which permits a surety to stand upon his strict legal rights, when applicable, does not prevent a construction of the bond with a view to determining the fair scope and meaning of the contract in the light of the language used, and the circumstances surrounding the parties.

"If literally construed, the obligation of the bond might be limited to secure only persons supplying labor or materials directly to the contractor, for which he would be personally liable. But we must not overlook, in construing this obligation, the manifest purpose of the statute to require that material and labor actually contributed to the construction of the public building shall be paid for, and to provide a security to that end.

"Looking to the terms of this statute in its original form, and as amended in 1905, we find the same congressional purpose to require payment for material and labor which have been furnished for the construction of public works. The affidavit to be filed with the head of the department under the direction of which the work has been prosecuted requires the affiant to state that labor or materials for the prosecution of such work has been supplied by him, for which payment has not been made, and such persons are given the right of action on the bond in the name of the United States. Language could hardly be plainer to evidence the intention of Congress to protect those whose labor or material has contributed to the prosecution of the work. There is no language in the statute nor in the bond which is herein authorized limiting the right of recovery to those who furnish material or labor directly to the contractor, but all persons supplying the contractor with labor or materials in the prosecution of the work provided for in the contract are to be protected. The source of the labor or material is not indicated or circumscribed. It is only required to be supplied to the contractor in the prosecution of the work provided for. How supplied is not stated, and could only be known as the work advanced and the labor and material are furnished.

"If a construction is given to the bond so limiting the obligation incurred as to permit only those to recover who have contracted it directly with the principal, it may happen that the material and labor which have contributed to the structure will not be paid for, owing to the default of subcontractors, and the manifest purpose of the statute to require compensation to those who have supplied such labor and material will be defeated.

"We cannot conceive that this construction works any hardship to the surety. The contractor gets the benefit of such work or material. It is distinctly averred in this case that the original contractor received

the benefit of the work done, and it was used in part performance of his contract. It is easy for the contractor to see to it that he and his surety are secured against loss by requiring those with whom he deals to give surety by bond, or otherwise, for the payment of such persons who furnish work or labor to go into the structure. In view of the declared purpose of the statute, in the light of which this bond must be read, and considering that the act declares in terms the purpose to protect those who have furnished labor or material in the prosecution of the work, we think it would be giving too narrow a construction to its terms to limit its benefits to those only who supply such labor or materials directly to the contractor. The obligation is 'to make full payments to all persons supplying it with labor or materials in the prosecution of the work provided for in said contract.' This language, read in the light of the statute, looks to the protection of those who supply the labor or materials provided for in the contract, and not to the particular contract or engagement under which the labor or materials were supplied. If the contractors see fit to let the work to a subcontractor, who employs labor and buys material which are used to carry out and fulfil the engagement of the original contract to construct a public building, he is thereby supplied with labor and materials for the fulfilment of his engagement as effectually as he would have been had he directly hired the labor or bought the materials."

One hesitates to criticise the opinions of a court of such eminent authority as that of the Supreme Court of the United States. However, the following comment on the foregoing opinion may, we think, be presented with entire propriety. The question as to whether the bond in suit covered claims for labor and material furnished not to the "risk," but to a third party, should be determined solely by ascertaining whether the contract entered into between the insured and the "risk" specifically provided for the payment by the "risk" of such labor and material claims. If it does, the contract insurance bond should be held to cover the liability resulting from their non-payment, otherwise not.[1]

[1] See generally on the construction of bonds given pursuant to federal statutes, the following cases: Am. Sur. Co. *v.* U. S. to the Use of Barrett, 127 Ala. 349; 28 Sou. 664; Am. Sur. Co. *v.* U. S. to Use of Watt, 77 Ill. App. 106; U. S. to Use of Bell *v.* Em. St. Sur. Co., 100 N. Y. Sup. 274; 114 App. Div. 755; Am. Bond. &

Having now briefly reviewed the decisions relative to the question, it only remains to comment thereon as follows: The rule adopted by the Supreme Courts of Wisconsin and Alabama seems, in the absence of special statutes requiring the execution of such bonds, to be the true one, and the only one that adapts itself to the universal principle of insurance law, that no one can become the beneficiary of a policy of contract insurance, save by the express or implied consent of the insurer. In addition to this, such beneficiary must have what is deemed in law an insurable interest in the policy which he seeks to enforce. The proper test as to the existence of such insurable interest is whether the claim that such beneficiary seeks to enforce against the insurer is equally enforceable in favor of such beneficiary as against the "risk."[1]

§ 179. **Construction of Contract Insurance Bonds.** — Since the first edition of this work was published (1902), a most pronounced tendency has been evinced by the courts in the direction of treating contracts of compensated sureties in matters of construction as being governed by different principles from that of the bond of the gratuitous surety. The tendency of the courts at the present time is unquestionably towards holding that in matters of construction the principles and rules of general insurance law, rather than those of gratuitous suretyship, should be applied to contract insurance bonds. In short, the *strictissimi juris* rule has no possible application to the contracts entered into by the surety companies for compensation. While recognizing the fact that the compensated surety's agreement is in itself a contract of insurance, it seems at times difficult for the judicial mind to perceive that the principles and rules of insurance law, rather

Tr. Co. *v.* U. S., 15 D. C. App. 397; U. S. to the Use of Heise, Bruns & Co. *v.* Am. Bond. & Tr. Co., 89 Fed. 925; 32 C. C. A. 420; Am. Bond. & Tr. Co. *v.* U. S., 15 App. D. C. 397; U. S. to Use of Flaherty *v.* Am. Sur. Co., 127 Fed. 490; U. S. Fid. & Guar. Co. *v.* U. S., 28 Sup. Ct. Rep. 537; Henningsen *v.* U. S. Fid. & Guar. Co., 208 U. S. 404.

[1] See Southern States Life Ins. Co., *et al.* *v.* Statham Ga. App., 61 S. E. 886.

than those of gratuitous suretyship, should be applied to contracts of this nature.[1]

The rule of construction to be applied to insurance bonds is well set forth in the leading case of Cowles *v.* United States Fidelity and Guaranty Company.[2]

"It is contended by appellant that a distinction exists between the liability of a non-compensated surety and that of a compensated surety, and that the doctrine of *strictissimi juris*, which has been invoked successfully by accommodation bondsmen, should not apply to parties who furnish bonds for compensation. We have not been able to obtain any light from the cases cited from this court, any further than that they discountenance the old rule that there should be a difference in construction between bonds and other contracts, even in cases where the bonds were given purely as a matter of accommodation. We think, however, on general authority, that while this class of suretyship is comparatively new, a distinction has been clearly evinced by the courts, and that this character of suretyship is governed by the rules governing insurance contracts. Guaranty insurance is thus defined by Mr. Frost in his work on the 'Law of Guaranty Insurance,' § 2, as follows: 'For purposes of classification and treatment herein, guaranty insurance contracts may be divided into three general classes, — those of fidelity, commercial and judicial insurances.' Commercial insurance is defined as having reference to indemnity agreements issued in the form of insurance bonds or policies, whereby parties to commercial contracts are to a designated extent guaranteed against loss by reason of a breach of contractual obligations on the part of the other contracting party. To this class belong policies of contract, credit and title insurances.'

"In his criticism on courts which have insisted on following the old rule the author pertinently remarks: 'It is but natural that courts so long accustomed to following the rule of favoritism shown towards the surety under the old-time private bonds should be slow to recognise that with the passing away of the reason for the extension of the rule by the advent of the compensated surety, the rule itself should pass away. A contract of guaranty insurance is entered into for a compensation, and usually after the fullest investigation and frequently under stipulations largely technical in character and based upon written representations relative to the nature and extent of the risk. The policy is written by a company incorporated for the express purpose

[1] See Am. Sur. Co., *et al. v.* Lauber, *et al.*, 22 Ind. App. 326; 53 N. E. 793.

[2] 32 Wash. 120; 72 Pac. 1032.

of furnishing guaranty bonds as a means of revenue for the corporation and its stockholders.' This class of insurance cannot be distinguished in principle from what is called guaranty insurance where the guaranty company guarantees the honesty and efficiency of employees. . . .

"The thing provided for in this contract was done, and the divergence from the strict terms of the contract was merely a matter of detail. The agreement for the alterations was made by all the parties who were entitled under the contract to make it. The consent was given by the party who was authorized to give consent; not, it is true, in the form prescribed, viz. in writing, but that goes more to form than to substance, and, in the absence of a showing of some damage, should not be allowed to avoid the contract or the policy of insurance which became part of it. *The bond is subject to the contract and was made after the contract.* It is the contract itself instead of the bond which is primarily to be construed, and the construction of the contract cannot be affected by the fact that a bond is given for its performance. It must be construed with reference to the intention of the parties to the contract, and whatever is binding upon them is binding upon the surety, who becomes a party to the contract, identified with the contractor (the 'risk')."

Again this same question was before the United States Supreme Court in United States Fidelity and Guaranty Company *v.* United States.[1] The main question in that case had reference to whether or not the *strictissimi juris* rule of construction should be applicable to a contract insurance bond. The case was submitted to the court very largely upon the authority of statements contained in the present work. In its opinion rendered in that case the court spoke as follows:

"The rule of *strictissimi juris* is a stringent one, and is liable at times to work a practical injustice. It is one which ought not to be extended to contracts not within the reason of the rule, particularly when the bond is underwritten by a corporation which has undertaken for a profit to insure the obligee against a failure of performance on the part of the principal obligor. Such a contract should be interpreted liberally in favor of the subcontractor, with a view of furthering the beneficent object of the statute. Of course, this rule would not extend to cases of fraud or unfair dealing on the part of a subcontractor,

[1] 191 U. S. 416; 46 L. E. 242.

as was the case in United States to the Use of Heise *v.* American Bonding and Trust Company,[1] or to cases not otherwise within the scope of the undertaking." [2]

Later, this same court in United States for the Use of Hill *v.* American Surety Company [3] spoke as follows:

"In considering the statute and determining the scope of the bond, divergent views have been urged upon the court. Upon the one hand, it is insisted that the bond is to be strictly construed, and a recovery limited to those who have furnished material or labor directly to the contractor, and upon the other, that a more liberal construction be given, and a recovery permitted to those who have furnished labor and materials which have been used in the prosecution of the work, whether furnished under the contract directly to the contractor or to a subcontractor.

"This statute was before this court in United States Fidelity and Guaranty Company *v.* Golden Pressed and Fire Brick Company,[4] and while the question whether surety companies which are such for compensation are entitled to the same strict construction of their rights and obligations as is accorded to private sureties who become such without reward or profit, was left open, it was nevertheless said: 'The rule of *strictissimi juris* is a stringent one, and is liable at times to work a practical injustice. It is one which ought not to be extended to contracts not within the reason of the rule, particularly when the bond is underwritten by a corporation which has undertaken for a profit to insure the obligee against a failure of performance on the part of the principal obligor. Such a contract should be interpreted liberally in favor of the subcontractor, with a view of furthering the beneficent objects of the statute. Of course the rule would not extend to cases of fraud or unfair dealing on the part of a subcontractor, as was the case in United States to the Use of Heise *v.* American Bonding and Trust Company,[5] or cases not otherwise within the scope of the undertaking.'

"The courts of this country have generally given to statutes intending to secure those furnishing labor and supplies for the construction of buildings a liberal interpretation, with a view of effecting their purpose to require payment to those who have contributed by their labor or material to the erection of buildings to be owned and enjoyed by

[1] 89 Fed. 921, 925.

[2] U. S. Fid. & Guar. Co. *v.* U. S., 191 U. S. 416; 48 L. E. 242.

[3] 200 U. S. 197.

[4] 191 U. S. 416; 48 L. E. 242; 24 Sup. Ct. Rep. 412.

[5] 89 Fed. 925.

those who profit by the contribution of such labor or materials.[1] And the rule which permits a surety to stand upon his strict legal rights, when applicable, does not prevent a construction of the bond with a view to determining the fair scope and meaning of the contract in the light of the language used and the circumstances surrounding the parties."[2]

In Hurley *v.* Fidelity and Deposit Company of Maryland[3] the court spoke as follows:

"It may be stated that it is so well settled as not to require the citation of authorities to establish it, that for the ascertainment of the intention of a guarantor, the written guarantee must be looked to; and if there is room for doubt or if uncertainty is found on the face thereof, the words are to be received and accepted in the strongest sense against the party using them, according to the maxim 'Verba fortius accipiuntur contra proferentem.' The defendant's undertaking was in the nature of a guarantee that its principal should perform its contract with the plaintiff, and as the bond in question was drawn by the defendant's agents and officers, it must be, according to the rule of construction, taken most strongly against it."[4]

In a leading case[5] the court observed that a contract, the performance of which is secured by a bond of a fidelity company as a part of the business in which it is engaged for a profit, is not to be interpreted under the same rules of construction applied to voluntary sureties.[6]

[1] Flagstaff Silver Min. Co. *v.* Cullins, 104 U. S. 176, 177; 26 L. E. 704, 705.

[2] Ulster County Sav. Inst. *v.* Young, 161 N. Y. 23, 30; 55 N. E. 483; see also U. S. Fid. & Guar. Co. *v.* U. S., 28 Sup. Ct. Rep. 537; Henningsen *v.* U. S. Fid. & Guar. Co., 208 U. S. 404.

[3] 95 Mo. Ct. of App. 88; 68 S. W. 958.

[4] To the same effect see Am. Sur. Co., *et al.* *v.* San Antonio Loan & Tr. Co. (Tex.) ; 98 S. W. 387; Gansevoort Bank *v.* Em. St. Sur. Co., 123 N. Y. App. Div. 331.

[5] City of New Haven *v.* Eastern Paving Brick Co., *et al.*, Conn. ; 63 Atl. 317.

[6] See to the same effect Van Buren Sur. Co. *v.* Am. Sur. Co., Ia. ; 115 N. W. 241; U. S. to Use of Vt. Marble Co. *v.* Bringdorf, 13 Dis. Col. App. 506; Pac. Bridge Co. *v.* U. S. Fid. & Guar. Co., *et al.*, 33 Wash. 47; 73 Pac. 772; see *contra*, U. S. to Use of Ann. Pipe & Foundry Co. *v.* Nat. Sur. Co., 92 Fed. 549; 34 C. C. A. 226; U. S. to Use of Heise, Bruns & Co. *v.* Am. Bond. & Tr. Co., 89 Fed. 921, 925; 32 C. C. A. 420; Am. Sur. Co. *v.* Halliwell Cem. Co., 57 Pac. 237; Electric Appliance Co. *v.* U. S.

It is safe to say that inasmuch as contract insurance bonds are by their nature insurance contracts, they must be construed like any other contract of insurance; that is, if they are capable of two constructions, one favorable and the other unfavorable to the insurer, the latter if consistent with the object for which the contract was made must be adopted. This for the reason that the contract itself, having been drafted by the surety company, any ambiguity in its terms must be construed in favor of the insured.[1]

When it is said that the principles of insurance law, rather than those of gratuitous suretyship apply to matters of construction, the following may be said as to the practical effect thereof in the case of contract insurance bonds. First, it abrogates entirely the *strictissimi juris* rule. Second, it causes all ambiguities in the bond to be solved in favor of the insured and against the insurer. This has a most important bearing in determining the scope of liability under such bonds. Third, it introduces into the domain of commercial insurance the doctrines of "misrepresentations," "concealment," "breach of warranties" and "conditions" as they exist in fire, marine, life and fidelity insurance.[2]

Fid. & Guar. Co., 110 Wis. 434; 86 N. W. 648; St. P. Tit. & Tr. Co. *v.* Sabin & the U. S. Fid. & Guar. Co., 112 Wis. 105; 87 N. W. 1109; City of Middletown *v.* Ætna Indemn. Co., 97 N. Y. App. Div. 344; Cit. Tr. & Sur. Co. *v.* Holwell, 19 Pa. Sup. Ct. 255; Ausplund *v.* Ætna Indemn. Co., 47 Ore. 10; 81 Pac. 577; Bateman Bros. *v.* Am. Sur. Co. of N. Y., *et al.*, 145 Cal. 241; 78 Pac. 734; Friend *v.* Ralston, 35 Wash. 422; 77 Pac. 494; Mich. S. S. Co. *v.* Am. Bond. Co., 95 N. Y. Sup. 1034; 109 App. Div. 55; Am. Bond. Co. *v.* Pub. Inv. Co., 150 Fed. 17; Nowell *v.* Mode, *et al.*, (Mo. App.); 111 S. W. 641.

[1] Am. Sur. Co. of N. Y., *et al.* *v.* San Antonio Loan and Tr. Co., Tex. ; 96 S. W. 387; Am. Bond. Co. of Baltimore *v.* City of Ottumwa, 137 Fed. 572; St. Paul Tit. & Tr. Co. *v.* Sabin & U. S. Fid. & Guar. Co., 112 Wis. 105; 87 N. W. 1109; Van Buren Sur. Co. *v.* Am. Sur. Co., Ia. ; 115 N. W. 241; U. S. Fid. & Guar. Co., 151 Fed. 534; Hurley *v.* Fid. & Dep. Co., 95 Mo. App. 88; 68 S. W. 958; Gansevoort Bank *v.* Em. St. Sur. Co., 123 N. Y. App. Div. 331; Nowell *v.* Mode, *et al.*, Mo. App. ; 111 S. W. 641.

[2] See U. S. Fid. & Guar. Co. *v.* First Nat. Bank, 233 Ill. 475; 84 N. E. 670.

§ 180. **Interpretation of Contract Insurance Bonds.** — In interpreting contract insurance bonds it must always be borne in mind that such bonds are invariably executed with reference to the contract, the faithful performance of which they are designed to secure.[1] Thus obligations of the bond must always be determined in connection with the terms and conditions of such contract.[2] The proper method of interpretation is to read the building contract into the bond in order to ascertain the full scope and purpose thereof.[3] The contract must always be given a rational construction and interpretation which, while it carefully restricts and enforces the liability to that which it agreed to undertake, yet does not fail to hold it to that liability which by the plain terms of its agreement it promised to assume. Written language has the same significance, and its meaning must be ascertained by the same rules of law when it is found in the contract of a surety company as when it appears in other agreements.

The only purpose of rules of interpretation is to ascertain the intention which the parties to an agreement expressed by their writing, and when that intention shines forth from the words of the agreement, or is lawfully ascertained therefrom, rules of construction are not available to defeat its proper enforcement. The purpose of every agreement is to regard the intention of the parties. The object of all construction is to ascertain that intention from the writing and to enforce it. The court so far as possible should put itself in the place of the parties when their minds met upon the terms of the agreement, and then from a consideration of the writing and of its purpose and all the circumstances which conditioned its making, endeavor to ascertain what they intended to agree to do, upon what

[1] McArthur, *et al.* *v.* McGilvray, *et al.*, 1 Ga. App. 463; 57 S. E. 1058.

[2] See Cowles *v.* U. S. Fid. & Guar. Co., 37 Wash. 695; 79 Pac. 1134.

[3] Ramlose *v.* Dolman, *et al.*, 100 Mo. App. 347; Searles *v.* City of Flora, 225 Ill. 167; N. E.

sense and meaning of the terms they used, their minds actually met.[1]

"That intention must be deduced not from some specific provision or fragmentary parts of the contract, but from the entire agreement, because the intent is not evidenced by any part or provision of it, but by every part and term so construed if possible as to agree with every other part and with the entire agreement.

"Where the language of an agreement is contradictory or ambiguous or where its meaning is doubtful, so that the contract is fairly supportable of two constructions, one of which makes it valid, customary and such as a prudent man would naturally execute, while the other makes it inequitable, unusual or such as responsible men would not be likely to enter into, the interpretation which makes it a legal and proper agreement must be preferred to that which makes it an unusual, inferior or improper contract.

"The intention of the parties when manifest or when ascertained from the written agreement in accordance with the basic rules of interpretation must control and be enforced without regard to inapt expressions and technical rules of interpretation unless that intention is directly contrary to the plain sense of the binding words of the agreement."[2]

In view of the fact that contract insurance bonds are invariably conditioned upon the faithful performance by the "risk" named in such bond of the terms and conditions of a contract theretofore entered into by such "risk" with the insured, it follows that all the conditions of such contract are imported bodily into the bond. It is the insurer's duty to investigate and ascertain what these conditions are, and it must be held to be bound by them. It will not be permitted to assert that it was never informed as to their character. Whatever they may be, so long as they are not *per se* illegal, the insurer has agreed that they shall be performed.[3]

[1] Am. Bond. Co. *v.* Public Indem. Co., 150 Fed. 17; Ovington *v.* Ætna Indemn. Co., 36 Wash. 473; 78 Pac. 1021.

[2] Am. Bond. Co. of Baltimore *v.* Pub. Ind. Co., 150 Fed. 17.

[3] St. P. Tit. & Tr. Co. *v.* Sabin & the U. S. Fid. & Guar. Co., 112 Wis. 105; 87 N. W. 1109; Ætna Indemn. Co. *v.* Ryan, 103 N. Y. Sup. 756; 53 Misc. 614; Town of Gastonia, *et al.* *v.* McEntee-Peterson Eng. Co., 131 N. C. 363; 42 S. E. 858; Ausplund

§ 181. **Applications and Proposals for Bonds.** — It frequently happens that a contract insurance bond is furnished by surety companies in response to two distinct applications, one of which is a proposal for a bond, running from the insured, and the other is an application for a bond proceeding from the "risk" to the insurer. The liability of the insurer upon the bond issued in response to such application and proposal, is limited to the penalty therein named.[1]

It has been held that where the insured signs a printed proposal for a contract insurance bond and delivered the same to the "surety company" which accepted the obligation and issued the bond thereon, this created a valid and enforceable contract, although the proposal for a bond was not accompanied by an application signed by the "risk." This, too, even where the bond specifically recites that the "surety company" signs the same, in consideration of the mutual covenants existing as between the "risk" and the insurer.[2]

§ 182. **The Execution of the Policy.**—A contract insurance bond signed in the name of the corporation by its executive officer with the corporate seal affixed, attested by the secretary, is a sealed instrument, and for the purpose of making the execution binding upon the corporation it is immaterial that the seal is not opposite the executive's signature.[3] It has been held, in connection with the bidding on their contracts by contractors, that after such bid has been accepted and approved, the bond may be lawfully executed either before the contract or the contract before the bond.[4]

v. Ætna Indemn. Co., 47 Ore. 10; 81 Pac. 577; First Nat. Bank *v.* School Dist. No. 1, *et al.*, 72 Neb. 681; 101 N. W. 340; Cowles *v.* U. S. Fid. & Guar. Co., 32 Wash. 120; 72 Pac. 1032; 37 Wash. 695; 79 Pac. 1194.

[1] U. S. *v.* Am. Sur. Co. of N. Y., 135 Fed. 78;

[2] Ætna Indemn. Co. *v.* Ryan, 103 N. Y. Sup. 756; 53 N. Y. Misc. 614.

[3] Weightman *v.* Union Tr. Co., 208 Pa. St. 449; 57 Atl. 789.

[4] Red Wing Sewer Pipe Co. *v.* Donnelly, *et al.*, 102 Minn. 192; 113 N. W. 1.

It has been held that where the insured signed a printed proposal for a contract insurance bond and delivered the same to the surety company which accepted the obligation and issued the bond thereon, there was a valid contract, although the proposal for a bond was not accompanied by an application signed by the "risk," even where the bond specifically recites that the "surety company" signs the same, in consideration of the mutual covenants existing as between the "risk" and the insurer.[1]

A building contractor's bond, though not signed on the same day as the contract, was written on the same sheet of paper as the contract and stamped as was the contract with a United States Revenue stamp. The cancellation of each of the stamps was done by the same mark, dated the same day in the same ink, and by the same hand. The person contracting with the building contractor absolutely refused to accept the contract without the bond and so informed one of the members of the firm which went surety for the contractor, who asked if his firm would be suitable as surety, and after being told that it would, signed his firm's name to the bond. The contractor at the time of signing the contract agreed to give a bond for the faithful discharge of his duties, and the bond and contract were delivered and took effect simultaneously. It was held, that though the contract and bond were not signed simultaneously, the contract did not become effective until the execution of the bond which was a part thereof and for which the consideration was sufficient, although the bond was given after the execution of the contract and the commencement of the work.[2]

After the contract has been entered into between the parties, they are both chargeable with knowledge of its contents whether they have read the same or not.[3]

[1] Ætna Indemn. Co. *v.* Ryan, 103 N. Y. Sup. 756; 53 Misc. 614.

[2] Kneisley Lumber Co. *v.* Edward B. Stoddard, *et al.*, (Mo. App.) ; 88 S. W. 744; see generally Roark *v.* City Tr. Safe Dep. & Sur. Co., (Mo. App.) ; 110 S. W. 1.

[3] J. C. W. Supply Co. *v.* Met. Cons. Co., N. J. ; 69 Atl. 1088.

§ 183. **Attachment of Liability.** — Questions relating to the attachment of liability under a contract insurance bond often resolve themselves into a solution of the question whether an agent is empowered to bind his principal in the making and execution of such bonds. In this connection a general agent is one empowered to transact all his principal's business of the general character which it operates itself, and which it is authorized to transact. Third persons acting in good faith are justified in relying upon the apparent authority of one held out as a general agent of his principal, notwithstanding some instructions and limitations placed by the principal upon such authority. The principal is bound for the acts of the general agent within the scope of his apparent authority even though such acts are not submitted by the agent to his principal for ratification. Such third persons may assume that the agent will promptly communicate to the principal all his dealings as carried on by him in the principal's behalf. On the issue of the authority of a general agent, third persons cannot rely on the agent's assumption of authority, but must be careful to observe that the agent moves within the apparent scope of his powers.[1]

On well recognized principles of estoppel, the courts will often hold that liability has attached under a contract insurance bond even where there have been informalities in the execution thereof or where the bond itself has not been delivered.[2]

The scope of liability under a contract insurance bond cannot under any circumstances be extended by construction so as to cover claims accruing prior to the execution of the bond.[3]

[1] Ætna Indemn. Co. *v.* Ladd, *et al.*, 15 Fed. 636; Am. Bond. & Tr. Co. of Baltimore *v.* Takahashi, *et al.*, 111 Fed. 125; see Anderson *v.* Nat. Sur. Co., 196 Pa. 288; 46 Atl. 306; Gritman *v.* U. S. Fid. & Guar. Co., *et al.*, Wash. ; 83 Pac. 6.

[2] Phila. to Use of, etc. *v.* Pierson, 211 Pa. 388; 60 Atl. 992; U. S. to Use of, etc. *v.* Merc. Tr. Co. of Pittsburg, 213 Pa. 411; Atl. ; Davis Belan & Co. *v.* Nat. Sur. Co., 139 Cal. 223; 72 Pac. 1001; Roark City Tr. Safe Dep. & Sur. Co., (Mo. App.) ; 110 S. W. 1.

[3] Phila. to Use of Neil, 206 Pa. 333; 55 Atl. 1032; City of Madison *v.* A. S. E. Co., *et al.*, 118 Wis. 480; 95 N. W. 1097.

The provisions in the governing procedure contained in the act of Congress of February 24, 1905,[1] and the act of August 1, 1894[2] for the protection of persons furnishing materials and labor for the construction of public works will not be given a retroactive effect as to apply to existing cases or cases where such amendatory statute, which consists of but one section, contains various provisions dealing with substantive rights which must be regarded as prospective in their operation.

Where one surety company absorbs all the assets and assumes all the liabilities of another and becomes in all respects its corporate successor it is liable on a bond executed by the latter on behalf of a building contractor to indemnify the owner against all claims, damages, liens, etc.[3]

§ 184. **Duration of Liability.** — In contract insurance questions as to the duration of liability are not so likely to arise as in other branches of insurance law. The policy is issued with direct reference to the provisions of a collateral contract, the faithful performance of which the bond is intended to secure. Thus ordinarily the life of such a contract itself determines the question of the duration of the "surety company's" liability on its bond; this in the absence of clauses in the policy providing otherwise.[4]

It has been said in this connection that in the case of policies issued to contractors for the benefit of material-men, that the failure to name any definite period of liability for such policies gives rise to the conclusion that as between the contractor and such material-men, only cash transactions were contemplated by the insurer when it furnished the indemnity to the insured against losses

[1] 33 Stat. at L. 811, 778; U. S. Comp. St. Sup., 1907, p. 709.

[2] 29 Stat. at L. 278, c. 280; U. S. Comp. St. 1901, p. 2523.

[3] Manny *v.* Nat. Sur. Co., 103 Mo. App. 717; see generally on time when liability attaches, Mich. S. S. Co. *v.* Am. Bond. Co., 104 N. Y. App. Div. 347; 93 N. Y. Sup. 805.

[4] U. S. to Use of Heise, Bruns & Co. *v.* Am. Bond. & Tr. Co., 89 Fed. 921; 32 C. C. A. 420.

arising through the failure of the risk to pay for materials furnished.[1]

It has been held that where the liability of a "risk's" surety was to continue until the completion of a building which the "risk" had agreed to erect, the time of the completion of such building should be construed as co-existent with the acceptance thereof so that the surety's liability continued until both contingencies occurred.[2]

Where several contract bonds are given at different times and remain outstanding and uncancelled, the later ones are to be regarded as cumulative and not as substitutes for the earlier ones.[3]

In a recent Colorado case, it appeared that the "risk" named in a contract insurance bond contracted with the party insured thereunder to thresh peas for the season of 1897 and agreed to protect him from liability incurred by the use of a particular machine as an infringement of the patent. A "surety company" executed a bond conditioned on the "risk's" performance of his agreement. The bond stipulated that the latter should pay in advance to the "surety company," on a specified date, a specified premium every year "for continuing the bond from year to year at the request of" the "risk" until the "company" "should be discharged"; the words quoted being written in the printed form. It was held that the bond obligated the "company" to indemnify the insured only against such liability as he might incur by the use of a particular machine during the season of 1897, and the company was not entitled to premiums after the expiration of that year in the absence of defendant requesting that the bond be continued.[4]

[1] U. S. to the Use of Heise, Bruns & Co. *v.* Am. Bond. & Tr. Co., 89 Fed. 925; 32 C. C. A. 420; see generally, Anderson, *et al.* *v.* Nat. Sur. Co., 196 Pa. 288; 46 Atl. 306.

[2] Ætna Indemn. Co. *v.* Ryan, 103 N. Y. Sup. 756; 53 Misc. 614; Fid. & Dep. Co. of Md. *v.* Schuhman, 88 S. W. 626.

[3] Commonwealth *v.* Enterprise Nat. Bank, *et al.*, 15 Pa. Dis. Ct. 949; see also Am. Sur. Co. *v.* Empson, 39 Col. 445; 89 Pac. 967.

[4] Am. Sur. Co. *v.* Empson, Col. ; 89 Pac. 967.

§ 185. **Scope of Liability.** — Any proper discussion of the scope of the insurer's liability in contract insurance must address itself to two main lines of inquiry. These are, first, the ascertainment of the persons for whose express or implied benefit the policy is issued; secondly, the determination of the nature and extent of the perils insured against. The first of these lines of inquiry has already been considered.[1] The second will be taken up for separate consideration in the section which follows.[2]

Ordinarily the scope of the insurer's liability in policies of contract insurance is co-extensive with the liability of the "risk" to the insured under a contract entered into between them to secure the faithful performance of which the policy is issued.[3]

It may be observed in passing that the absence of care or the presence of gross negligence on the part of the insured relative to superintending the "risk" in the performance of his contract, constitutes no defence to an action to enforce the insurer's liability under a policy of contract insurance. The only test of the insured's right to recover is the existence of a breach of the covenants of the policy on which the action is based.[4] In other words, the "doctrine of laches," in the absence of actual fraud or collusion on the part of the insured, has no application to contract insurance.

§ 186. **Scope of Liability as to Perils Insured Against.** — To ascertain whether the perils insured against are covered by the policy of contract insurance reference must always be had to the contract previously entered into between the "risk" and the insured, to secure the faithful performance of which the policy is issued.[5] Ordinarily each case is governed

[1] See *ante*, §178.

[2] See generally, Union Guar. & Tr. Co. *v.* Robinson, 79 Fed. 420; 24 C. C. A. 650.

[3] See Am. Sur. Co. *v.* Woods, 105 Fed. 741; 45 C. C. A. 282; Kneisley Lumber Co. *v.* Edw. B. Stoddard Co., *et al.*, (Mo. App.); 88 S. W. 744.

[4] Nat. Sur. Co. *v.* Long, 125 Fed. 887.

[5] See Am. Sur. Co. *v.* Woods, 105 Fed. 741; 45 C. C. A. 282.

by the particular wording of the bond sued on. In explanation of this statement attention is called to the following cases.

A contractor's bond, furnished by a surety company, conditioned that the "risk" therein named should promptly make payment to all persons supplying materials and labor in the construction of the work provided for in the contract entered into between the contractor and the government, was held to be broad enough to include within its protection one who supplied coal to the contractor which was used to operate heat and power engines employed in the work.[1]

The foregoing decision is however wholly opposed to the construction of the same federal statute as made by the Court of Appeals of the District of Columbia.[2]

An insurer issuing a contract insurance bond in behalf of a certain contractor as the "risk" therein named is liable in favor of one supplying materials, for the price of the materials so furnished which actually enter into the work, together with the expense of transporting the same to the place where the work is being done. It is also liable for materials used in the construction of false works necessary in the performance of the contract. Where the insured supplies materials to the "risk," for a part of which he was protected by the bond, and for a part of which he was not, as between him and the insurer issuing such bond, payments made on account generally by the "risk" should be applied to the payment for materials furnished and charged prior to the dates of such payment.[3]

In Mullin and Fidelity and Deposit Company *v.* United States to the use of Chapin-Hall Lumber Company[4] a con-

[1] City Tr., Safe Dep. & Sur. Co. of Phila. *v.* U. S. to Use of Bryant, *et al.*, 147 Fed. 155.

[2] See U. S. to the Use of Chapman *v.* City Tr., Safe Dep. & Sur. Co., 23 App. D. C. 153; following U. S. to Use of Standard Oil Co. *v.* City Tr., Safe Dep. & Sur. Co., 21 App. Dis. Col. 369; U. S. to the Use of Briscoe *v.* City Tr., Safe Dep. & Sur. Co., 23 App. D. C. 155.

[3] U. S. to the Use of, etc. *v.* Am. Sur. Co., *et al.*, 111 Fed. 474.

[4] 109 Fed. 817.

tract insurance bond had been furnished to a contractor for the benefit of material-men, conditioned for prompt payment of all claims. One of the insured contracted to furnish the contractor material on condition that 80 per cent of that put in place should be paid for the first of each month, the balance to be paid for on completion of the work. It was held that the contractor having failed to make the 80 per cent payments, and the insured having thereupon refused to proceed under the contract and treated it as rescinded, the 20 per cent became due with the rest and could be recovered of the insurer under the bond before the completion of the work.

An important principle was established in American Surety Company, *et al.* *v.* San Antonio Loan and Trust Company[1] relative to what state of facts will excuse a contractor from doing what he agreed to do, so as to release him from liability and his surety from liability on his bond. On this subject the court in the case just referred to spoke as follows:

"Do the facts pleaded excuse the contractors from doing what they agreed to do? The American rule is that where the contract is to build or complete a house on the employer's land, the contractor is not exempt from liability as for breach of contract, although he had never been prevented from performing it solely by some accident or casualty, by which the result of his work before completion has been destroyed without any fault of his. The principle is elementary, that 'if one for a valid consideration promises to another to do that which is in fact impossible, but the promise is not obtained by actual or constructive fraud and is not on its face physically impossible, there is no reason why the promisor should not be held to pay damages for the breach of the contract; not in fact for not doing what cannot be done, but for undertaking and promising to do it.' So if it becomes impossible by contingencies which should have been foreseen and provided against in the contract, and still more if they might have been prevented, the contractor should not be held answerable. So, if the impossible applies to the contractor personally, there being no natural impossibility in the thing, this will be insufficient to excuse. As is said by the Supreme Court of the United States in United States *v.* Gleason,[2] 'It is a well-settled rule in this branch of the law that

[1] Tex. ; 98 S. W. 387.

[2] 175 U. S. 588; 20 Sup. Ct. 228; 40 L. E. 289.

if a party by his contract charges himself with an obligation possible to be performed he must make it good unless his performance is rendered impossible by the act of God, the law or the other party.' If parties have made no provision for disasters, the rule of law governs, when only under such circumstances can equity interpose.

". . . It is a well-settled law that one contracting to furnish labor and material and construct the entire work is not excused from the performance of the contract by the destruction of the work whether from his own negligence, or accident, and not only can he receive nothing for the work already done, but is liable to the employer for money advanced upon the contract and for damages for its non-performance."

A case presenting many interesting features is that of Leffert *v.* Flaggs and the United States Fidelity and Guaranty Company.[1] The following is a statement of the essential facts therein.

A contract for the erection of a house for the plaintiff provided that the builder " will be personally responsible," to the owner of the property adjoining on the west of said building to be erected, for any damage or injury done to said building by the erection of the building here contracted to be erected." One of the defendants (a "surety company") executed a bond to indemnify plaintiff from loss resulting from the breach of any of the terms of the contract by the builder. In the construction of plaintiff's house the builder while excavating upon his land injured the wall of the house adjoining on the west in such a manner that the plaintiff was liable for such damages and paid the same. It was held that the stipulation in the contract was not to be regarded as a promise to plaintiff for the benefit of the owner of the adjoining house enforceable only by the latter, but that the builder and his surety are liable directly to the plaintiff for the injury to the adjoining house for which the plaintiff was liable and which he had paid. The court further held that in an action against the surety and the builder the record of a suit against the plaintiff by the owner of the adjoining house to recover

[1] 101 Md. 71; 60 Atl. 450.

damages for the injury so caused, was admissible as *prima facie* evidence of the fact of injury by the builder of the adjoining house and the amount of damage thereby occasioned.[1]

[1] See the following cases generally as to scope of liability under contract insurance bonds: U. S. to Use of Nicola Bros. Co. *v.* Hegeman, *et al.*, 54 Atl. 344; 204 Pa. 438; Todd *v.* Franzog (U. S. Fid. & Guar. Co., intervenors), 44 Wash. 520; 87 Pac. 831; Thomas Laughlin Co., *et al. v.* Am. Sur. Co. of N. Y., 114 Fed. 627; Fid. & Dep. Co. of Md. *v.* Parkinson, 68 Neb. 319; 94 N. W. 120; Phila. to Use of, etc. *v.* Neil & Lincoln County Sav. & Tr. Co., 211 Pa. 353; 60 Atl. 1033; Hipwell *v.* Nat. Sur. Co., *et al.*, 130 Ia. 656; 105 N. W. 318; Equitable Tr. Co. *v.* Bowen, 201 Pa. 534; 51 Atl. 371; Westcott *v.* Fid. & Dep. Co., 87 N. Y. App. Div. 497; U. S., *ex rel.* McAllister *v.* Fid. & Dep. Co., 86 N. Y. App. Div. 475; Beal *v.* Fid. & Dep. Co., 76 N. Y. 526; Town of Gastonia, *et al. v.* McEntee-Peterson Eng. Co., 131 N. C. 363; 42 S. E. 858; Callahan *v.* Ætna Indemn. Co., 33 Wash. 583; 74 Pac. 693; Folz *v.* Tradesmen's Tr. & Sav. Co., *et al.*, 201 Pa. 583; 51 Atl. 379; Buffalo Ger. Ins. Co. *v.* Fid. & Guar. & Tr. Co., 99 N. Y. Sup. 883; 51 Misc. 267; Selbey, *et al. v.* City of New Orleans, 119 La. 900; 44 Sou. 722; Young *v.* Tr. Assets & Inv. Sur. Co., 21 Rettie (Scotch Ses. Cas.) 222; Laird *v.* Sec. Ins. Co., 22 Rettie (Scotch Ses. Cas.) 452; Am. Sur. Co. *v.* Woods, 105 Fed. 741; 106 Fed. 263; 45 C. C. A. 282; Anderson, *et al. v.* Nat. Sur. Co., 196 Pa. 288; 46 Atl. 306; Beal, *et al. v.* Fid. & Dep. Co., 78 N. Y. Sup. 584; 76 App. Div. 526; Zipps *v.* Fid. & Dep. Co., 76 N. Y. Sup. 386; 73 App. Div. 20; Leppert *v.* Flaggs & the U. S. Fid. & Guar. Co., 101 Md. 71; 60 Atl. 450; Union Tr. Co. *v.* City Tr. Co., 185 Pa. 217; Snoquahim R. R. Co. *v.* Am. Sur. Co., 179 Mo. 629; 78 S. W. 1014; Alcatraz Masonic Hall Ass. *v.* U. S. Fid. & Guar. Co., 3 Cal. App. 338; 85 Pac. 156; Hefferman *v.* U. S. Fid. & Guar. Co., *et al.*, 37 Wash. 465; 79 Pac. 1095; Allen Co. *v.* U. S. Fid. & Guar. Co., (Ky.); 93 S. W. 44; Equitable Tr. Co. *v.* Nat. Sur. Co., Pa. ; 63 Atl. 699; Crane *v.* Ætna Indemn. Co., *et al.*, 43 Wash. 576; 86 Pac. 849; Am. Bond. & Tr. Co. *v.* U. S. to Use of S. Dana Lincoln, 15 Dis. Col. App. cas. 397; City of New Haven *v.* Eastern Pav. Brick Co., *et al.*, Conn. ; 63 Atl. 517; U. S. to Use of Standard Oil Co. *v.* City Tr., Safe Dep. & Sur. Co., 21 App. D. C. 369; U. S. *v.* Fid. & Dep. Co. of Md., 132 Fed. 82; Jenkins *v.* Am. Sur. Co., Wash. ; 88 Pac. 1112; Quarries Co., Ltd. *v.* Fid. & Guar. Co., 78 Vt. 445; Herpolisheiner *v.* Hansell-Elcock Co., 141 Mich. 367; 104 N. W. 671; Hardison & Co. *v.* Yeaman, *et al.*, 115 Tenn. 639; City of St. Louis *v.* Wright Cons. Co., 202 Mo. 451; 101 S. W. 6; Salmen Brick & Lumber Co. *v.* Le Sassier, *et al.* in *re* Fid. & Dep. Co. of Md., 106 La. 389; 31 Sou. 7; Hardway & Prowell *v.* Nat. Sur. Co., 150 Fed. 465; Phila. *v.* Malone, 214 Pa. 90; Atl. ; U. S. *v.* Higginson, *et al.*, 16 Pa. Sup. Ct. 799; U. S. *v.* Am. Sur. Co., 21 Pa. Sup. Ct. 159; Fid. & Dep. Co. of Md. *v.* Parkinson, 68 Neb. 319; 94 N. W. 120; Lancaster County, *et al. v.* Fitzgerald,

§ 187. **The Liability of the Insurer under Contract Insurance. How Discharged.** — The discharge of the insurer's liability under policies of contract insurance may be accomplished in any one of the following ways:

First. By cancellation or rescission of the contract.

Second. By misrepresentation on the part of the insured.

Third. By concealment on the part of the insured.

Fourth. By breach of warranty on the part of the insured.

Fifth. By breach of conditions on the part of the insured.

Sixth. By alteration of the contract entered into between the insurer and the "risk" not assented to by the insurer.

Seventh. By release by the insured of the liability of the "risk" to it.

Eighth. By release by the insured of any security held by it to secure the faithful performance by the "risk" of the contract entered into between such "risk" and the insured.

Ninth. By settlement of the loss under the policy by the insurer with the insured.

§ 188. **Discharge of Liability by Rescission or Cancellation.** — The same principles and rules are applicable here that have been set forth in previous sections of this work. For a discussion of these subjects reference is invited thereto.[1] Attention might be called in passing to the case of Ripley Building Company *v.* Coors.[2] In this case the court held that a surety on a bond for the faithful performance of a building contract is not released though induced to execute the bond by fraudulent representations of the "risk." This, too, even though before anything is done under the contract the surety informs the obligee thereof and gives notice of with-

74 Neb. 433; 104 N. W. 875; U. S. to the Use of Briscoe *v.* City Tr., Safe Dep. & Sur. Co., 23 App. D. C. 155; U. S. to the Use of Chapman *v.* City Tr., Safe Dep. & Sur. Co., 23 App. D. C. 153; Van Buren Sur. Co. *v.* Am. Sur. Co., Ia. ; 115 N. W. 241; Fid. Ins., Tr. & Safe Dep. Co. *v.* Earle, 23 Pa. Co. Ct. 449; see generally, Am. Sur. Co., *et al.* *v.* Lauber, *et al.*, 22 Ind. App. 326; 53 N. E. 793.

1 See *ante*, §§ 52–54.

2 37 Col. 78; 84 Pac. 817.

drawal therefrom. This holding was made on the ground that the surety bond having been provided for in the building contract, the cancellation thereof would make the "risk" liable for damages to the insured for a breach of the building contract. The court laid down the general rule that sureties should not be allowed to relieve themselves of liability imposed upon them by voluntary contracts by mere notice to their obligees that they were induced to enter into such contracts relying upon false statements made to them by the "risk," of which statements the obligees are entirely ignorant.[1]

§ 189. **Discharge of Liability by Misrepresentation on the Part of the Insured.** — The insured, under and prior to the issuance of a policy of contract insurance, was asked whether he knew of any outstanding liabilities of the "risk" and in reply stated that he did not know of any outstanding liabilities at the time. It appeared that when this statement was made the "risk" was indebted to the insured. In holding that this misrepresentation served to release the insurer, the court said that a "high degree of candor is required of a party answering such inquiries, who is to profit by the liability about to be assumed by the insured. . . . The answer as to the outstanding liabilities was not a matter of opinion, but a misstatement of a material fact, of which the party answering had knowledge, and the existence of which, if disclosed, was well calculated to influence the insurer to decline to go upon the bond, or to see to it that the money paid by the government to the contractor was applied to the payment of the debtor for the materials for the payment of which the company became liable as surety."[2]

[1] See also York City School Dist. *v.* Ætna Indemn. Co., 131 Fed. 131; Hanley *v.* U. S. Fid. & Guar. Co., 131 Mich. 601; 92 N. W. 106; Ætna Indemn. Co. *v.* Auto Traction Co., 147 Fed. 95; Romine *v.* Howard, *et al.*, (Tex.) ; 93 S. W. 690; Am. Bond. & Tr. Co. *v.* B. & O. S. W. R. R. Co., 124 Fed. 866.

[2] U. S. to the Use of Heise, Bruns & Co. *v.* Am. Bond. & Tr. Co., 89 Fed. 921.

Where a compensated surety furnishes a bond for the purpose of securing the payment of a bond and mortgage executed by the principal obligor to the obligee, the fact that the bond erroneously recited that the premises were covered by prior mortgages amounting to $91,000, when in fact the prior mortgages amounted to $94,000, is not such a misrepresentation as will serve to relieve the insurer upon the bond.[1]

The mere fact that a builder's contract and bond referred to the obligee in the bond as " owner " of the premises, when in fact the legal title is in another, is not such a false representation as will release the surety from liability.[2]

If the principal by fraud induced the surety to become bound but the obligee has no notice thereof, such fraud will, as a general rule, be no defence to the surety.[3]

§ 190. **Discharge of Liability by Concealment on the Part of the Insured.** — On the application of the insured, an insurer wrote an instrument in the form of a contract insurance policy, whereby it guaranteed the solvency of a person who was surety for the repayment by the borrower of money lent by the insured. The insurer made no inquiry as to the rate of interest payable by the borrower, or as to the circumstances of the loan, and no information was given him on these points. In fact, the interest was over 30 per cent and the borrower was unable to pay the loan. In an action on the policy the jury found that the transaction was not one of exceptional risk. It was held on appeal, that the non-disclosure of the rate of interest and of the circumstances of the loan did not constitute a defence, there being no evidence that those facts were material to the only risk undertaken by the respondent; namely, the solvency of the surety,

[1] Raymond *v.* Tallman & Union Sur. & Guar. Co., 100 N. Y. App. Div. 400; 91 N. Y. Sup. 670.

[2] Gretchel & Martin Lumber Mfg. Co. *v.* Peterson & Sampson, 124 Ia. 597; 100 N. W. 556.

[3] Ripley Bldg. Co. *v.* Coors, 37 Col. 78; 84 Pac. 817; see also Phila. to Use of Neil, 206 Pa. 333; 55 Atl. 1032.

and that the insurer made no inquiries as to the circumstances under which the loan was made.[1]

§ 191. **Discharge of Liability by Breach of Warranty.** — In the case of American Surety Co. *v.* San Antonio Loan and Trust Company[2] an attempt was made to hold a compensated surety for failure on the part of the "risk" named in a contract insurance bond to erect a building according to the plans and specifications of an architect named in the contract entered into between the insured and the "risk," the faithful performance of the conditions of which were guaranteed by the contract insurance bond. When the building neared completion it collapsed solely by reason of the defects in the plans and specifications and on account of orders given the contractors with respect to materials to be used and the method of construction. The court held that this did not excuse the contractors from performance of their contract, and the court refused to spell into their building contract or the contract insurance bond a warranty that the plans of the architect were free from defects. The court held, also, that the undertaking of an architect employed to prepare plans and specifications for a building and to strengthen its construction implies that he possesses skill and ability sufficient to enable him to perform his contract ordinarily and reasonably well and that he will exercise his skill and ability reasonably and without neglect, and if he exercises the skill and care of those ordinarily engaged in the business, and uses his best judgment, he is not liable for faults in the construction caused by defects in his plans. The court further held in this same case that in the absence of any express warranty if a building falls before completion on account of inherent defects in the plans, the contractor

[1] Seaton *v.* Bernand, 1900 App. Cas. 135; reversing Seaton *v.* Heath, 1899, 1 Q. B. 782; see also Nat. Sur. Co. *v.* T. B. T. Br. & Con. Co., 74 Ill. App. 312; 176 Ill. 156; 52 N. E. 938; Nat. Sur. Co. *v.* Long, 125 Fed. 887; Gretchel & Martin Lumber Mfg. Co. *v.* Nat. Sur. Co., 124 Ia. 617; 100 N. W. 556.

[2] (Tex.) ; 98 S. W. 387.

and his sureties must bear the loss, but if it falls for the same reason after completion, the loss must be borne by the owner (the insured).

In the absence of an express warranty in a building contract as to sufficiency of plans, one should not be implied unless there is the clearest reason for it. The burden of showing the breach of an implied warranty of sufficiency of building plans is on him who seeks its protection.[1]

The immateriality of a warranty or of a condition precedent made by the agreement of the parties and the innocuousness of a failure to perform it, do not qualify or mitigate the fatal effect of such a failure prescribed by their agreement.[2]

§ 192. **Conditions Defined, Classified and Discussed.** — A condition in the law of contract insurance is a proviso inserted in the body of the policy which serves to define, limit or avoid the principal obligation of the insurer to the insured in case the latter fails to comply with its terms. Conditions may be classified into conditions precedent and conditions subsequent. It is not indispensable to the validity or to the enforcement of conditions in policies of contract insurance that the insurer should be required to either establish their beneficence or materiality, or that it should be required to show that it has sustained injury from the failure of the insured to comply therewith. Parties to agreements have the right and power to contract with things immaterial as well as things material, which shall operate as conditions precedent or subsequent to their liabilities, and their contracts in the one case are as binding as in the other.

The all-sufficient and conclusive answer to suggestions that the subject of a condition is immaterial, is that the parties had the right to create different conditions before they decided to contract otherwise. In short, the immateriality of a condition made by the agreement of the parties or the innocuousness of a failure to perform it, do not qualify or mitigate the

[1] (Tex.) ; 98 S. W. 387.
[2] Nat. Sur. Co. *v.* Long, 125 Fed. 887.

fatal effect of the failure on the part of the insured to perform it.[1] The insurer always has the right to contract with the insured so that its liability shall be subject to reasonable conditions.[2]

Again, it may be said that the insurer is discharged from all liability where a condition — inserted in the policy and as such one which the insured agreed to be bound by — is not substantially complied with.[3]

Finally, it should be borne in mind, that as between the insured and the insurer he who commits the first substantial breach of the contract entered into between them cannot maintain an action against the other contracting party for a subsequent failure on his part to perform it.[4]

§ 193. **Conditions Precedent to the Creation of Liability under the Policy.** — The conditions above referred to may be classified as follows:

(A) Condition requiring the signature of the "risk" to the bond as a condition precedent to the creation of the insurer's liability thereunder.

(B) Condition requiring the signature of some designated officer of the insurer to the policy before it shall become binding.

(C) Condition requiring the approval of the bond by some designated person in behalf of the insured before the same shall become binding.

(D) Condition to the effect that to render the insurer liable under the policy there must co-exist a liability of the same character in favor of the insured against the "risk."

(E) Condition requiring the payment of the premium as a condition precedent to the creation of liability under the policy.

[1] Nat. Sur. Co. *v.* Long, 125 Fed. 887.

[2] McGarry, *et al.* *v.* Seitz, *et al.*, 129 Ga. 296; 58 S. E. 856; Earle *v.* Fid. & Dep. Co., (N. J.) ; 68 Atl. 1078; Raymond *v.* Tallman, 91 N. Y. Sup. 670; 100 App. Div. 400.

[3] Nat. Sur. Co. *v.* Long, 125 Fed. 887.

[4] *Idem.*

§ 194. (A) **Condition Requiring the Signature of the "Risk" to the Bond as a Condition Precedent to the Creation of the Insurer's Liability thereunder.** — Frequently contract insurance policies contain a provision making the obtaining of the signature of the "risk" to the policy furnished by the insurer to the insured a condition precedent to the creation of liability thereon on the part of the insurer to the insured. In sustaining the validity of such a condition the Supreme Court of Nebraska [1] spoke as follows:

> "It is a matter of indifference whether the insurer's demand, requiring the 'risk' to be bound by the instrument (the policy) would be for its advantage or not. It had the right to prescribe such conditions as it saw fit, and to become bound, if at all, when and in such manner as it chose. The condition, however, was for its advantage. Had the 'risk' signed the instrument the insurer would have been entitled to have been made a party to any suit and in case of recovery in such suit to have had his properties exhausted for the satisfaction of the judgment, and in case of payment by itself to have the right of exoneration determined and the amount thereof ascertained without the expense, delay and uncertainty of any suit upon the contract." [2]

§ 195. (B) **Condition Requiring the Signature of Some Designated Officer of the Insurer to the Policy before it shall become binding.** — In the case of Pacific National Bank *v.* Ætna Indemnity Company [3] a letter of attorney was given to a general agent of a surety company empowering him to execute bonds guaranteeing the fidelity of persons holding positions of public or private trust, and the "performance of contract other than insurance policies." It was held that such letter authorized the execution of a bond guaranteeing the performance of a contract to repay money advanced to a building contractor. In this case a contract insurance bond had been issued guaranteeing the performance of a contract by S. as trustee for another, and it was therein stipulated that "this

[1] Am. Radiator Co. *v.* Am. Bond. & Tr. Co., 72 Neb. 100; 100 N. W. 138.

[2] See to the same effect Ætna Indemn. Co. *v.* Ryan, 103 N. Y. Sup. 756; 53 Misc. 614.

[3] 33 Wash. 428; 74 Pac. 590.

bond shall not be valid until signed by the district agent." The evidence, however, showed that the general agent of the insurer had had the stipulation printed on the bonds on his own initiative, and the requirement was not made by the general officers of the insurer. The general agent personally induced the insured to incur obligations on behalf of S. as trustee, giving the bond as indemnity and delivering it to himself without having secured S.'s signature as a matter of form. It was held that the bond became effective without S.'s signature and was not invalid on the theory that plaintiff acted as agent for both the "risk" and the insured. Even were the "risk's" signature necessary, the general agent was acting within the scope of his authority, and his consent to S.'s signature must be admitted to have been with the knowledge and consent of the insurer, and that therefore the latter must have been deemed to have waived the signature.

The general agent having acted on the belief that by the issuance of the bond the insurer could be saved a loss upon a prior bond by reason of advancements made thereunder which he procured, the insurer was in no position to assert that it did not consent to the waiving of the procuring of the district agent's signature.[1]

§ 196. (C) **Condition Requiring the Approval of the Bond by Some Designated Person in Behalf of the Insured before the same shall become binding.** — As a general rule all such conditions as are here referred to are imposed by statute and are not found in the contract insurance bond itself. The ruling of the courts invariably is that such conditions have their origin in the statute and should be regarded as solely for the benefit of the insured, and a breach thereof is not available by the insurer as a defence to an action brought against it by the insured on the bond.[2]

[1] See generally on subject of conditions precedent, Earle *v.* Fid. & Dep. Co., (N. J.) ; 68 Atl. 1078.

[2] Phila. to the Use, etc. *v.* Pierson, 211 Pa. St. 388; 60 Atl. 999; City of Milbank *v.* West Secur. Co., S. D. ; 111 N. W. 561; City of Madison *v.* A. S. E. Co., *et al.*, 118 Wis. 480; 95 N. W. 1097.

In a recent Washington case[1] the court had occasion to comment on the purpose of statutory requirements designating a particular office wherein statutory bonds should be filed in the following language:

"The plaintiff contends however that it was excused from giving the notice, because the bond was not filed with the county auditor. The trial court found as a fact that the bond was not filed with the county auditor. But we find no evidence in the record to sustain that finding and the county auditor was not called as a witness. The only evidence upon the question is given by the clerk of the school board who testified that the bond was given before he came into office, that there were usually two bonds given on all these contracts, one running to the state of Washington and the other to the school district, and that he did not know whether the bond running to the state was filed with the auditor or not; that the bond in his possession was the one to the school district which was not to be filed with the auditor and was not so filed. This is the subject of the evidence upon the point that the bond sued on was not filed with the county auditor. The one sued upon was the one running to the state of Washington as required by statute. There is no evidence in the record which even tends to show that it was not filed as required by law. But if we were to hold that the bond was not filed with the county auditor, this fact does not relieve the plaintiff from filing the notice required by the statute. The object of filing the bond was to give notice to persons furnishing materials."

§ 197. (D) **Condition to the Effect that to Render the Insurer Liable under the Policy there must Co-exist a Liability of the same Character in Favor of the Insured against the "Risk."** — The principle is unquestioned that the insurer who has issued a contract insurance bond for the due fulfilment of a certain contract has the right to insist that his liability shall be measured and determined by the identical contract the performance of which he has guaranteed.[2] Every case involving the enforcement of a contract insurance bond in favor of the insured against the insurer issuing the same necessarily brings for review before the court two contracts.

[1] Crane *v.* Ætna Indemn. Co., Wash. ; 86 Pac. 849.

[2] New Haven *v.* Nat. Steam Economizer Co., 79 Conn. 482; 65 Atl. 959.

The first or principal one is the contract, the faithful performance of which is guaranteed; to this the "risk" and the insured are alone parties. This contract defines their respective undertakings.

The second contract is the one whereby the insurer guarantees to the insured the faithful performance of the first contract by the "risk." To this latter contract only the insurer and the insured are the necessary parties. It is this latter contract, therefore, which defines the respective obligations of the insurer to the insured.[1]

From what has been said it is clearly apparent that in order to render a claim by the insured on the bond against the insurer enforceable there must be in existence at the same time a corresponding claim valid and enforceable in favor of the insured as against the "risk" named in the contract insurance bond.[2]

§ 198. (E) **Condition Requiring the Payment of the Premium as a Condition Precedent to the Creation of Liability under the Policy.** — Ordinarily the consideration for the issuing of a contract insurance bond is the payment of a premium or the agreement to pay a premium for the issuing thereof.[3] It may be said in this connection that often where the payment of a premium is made a condition precedent to liability on the bond on the part of the insurer the latter may often be held to its liability under the bond on the plain principles of equitable estoppel.[4]

[1] New Haven *v.* Nat. Steam Economizer Co., 79 Conn. 48; 65 Atl. 959.

[2] *Idem.*; Boehmer *v.* Schuylkill Co., 46 Pa. St. 452; Johnson *v.* Ætna Indemn. Co., Wash. ; 90 Pac. 590; Alcatraz Masonic Hall Ass. *v.* U. S. Fid. & Guar. Co., 3 Cal. App. 338; 85 Pac. 156; Am. Bond. & Tr. Co., *et al.* *v.* Gibbon Co., 145 Fed. 871; Herpolsheiner *v.* Hansell-Elcock Co., 141 Mich. 367; 104 N. W. 671; McGarry, *et al.* *v.* Seitz, *et al.*, 129 Ga. 296; 58 S. E. 856; Westcott *v.* Fid. & Dep. Co., 84 N. Y. Sup. 731.

[3] Hanley *v.* U. S. Fid. & Guar. Co., 131 Mich. 601; 92 N. W. 106.

[4] Davis Belan & Co. *v.* Nat. Sur. Co., 139 Cal. 223; 72 Pac. 1001; U. S. Fid. & Guar. Co. *v.* Shirk, *et al.*, Okla. ; 95 Pac. 218; Sweeney *v.* Ætna Indemn. Co., 34 Wash. 126; 74 Pac. 1057; Roark *v.* City Tr., Safe Dep. & Sur. Co., Mo. App. ; 110 S. W. 1.

The presence of a seal upon the bond issued implies a consideration.[1] The question as to whether the payment of the premium by the insured to the insurer is necessary to the creation of liability under a contract insurance bond was before the Supreme Court of Washington in a recent case. Reference is here made to the case of Pacific National Bank of Tacoma *v.* Ætna Indemnity Company.[2] The court in its opinion in that case spoke as follows:

"Appellant, however, cites 'Frost on the Law of Guaranty Insurance,' § 29, as supporting its contention that such a guaranty contract as the one before us is not binding unless the premium has been paid to the insurer. The author states that the existence of the premium as a consideration distinguishes the contract from the obligation of private and gratuitous suretyship. He cites but one case in support of the paragraph cited,[3] but we are unable to see that the case is authority for the statement of the author. We understand it to be cited only on the point that the 'premium, in the absence of special provisions in the policy authorizing it, cannot be recovered back by the insured before offering to surrender up his policy. We are therefore left with the unsupported statement of the author. The broad doctrine announced, should, if legitimately applied, seem to make it necessary in all cases for the person who is to be protected by a guaranteeing bond to see that the principal therein has been paid the premium, and that, too, without regard to the fact that the bond has been actually delivered by the insurer. It seems to us that the rule must be, when the insurer delivers a bond guaranteeing another, that the beneficiary may assume that the premium has been paid; otherwise that the bond would not have been executed and delivered; and that the insurer cannot afterwards be heard to say that the premium was not paid as against the beneficiary, who has in good faith parted with value on the strength of the terms in the bond. Especially must this be so when there is no recital in the bond that the payment of the premium is a necessary prerequisite to the giving of fidelity."

The foregoing opinion in so far as it states the law governing the particular question now before us — meets with the fullest approval of the writer. But the statement in the

[1] Monroe, *et al.* *v.* Nat. Sur. Co., *et al.*, 92 Pac. 280.

[2] 33 Wash. 428; 74 Pac. 590.

[3] People, *ex rel.* Nat. Sur. Co. *v.* Feitner, 166 N. Y. 129; 59 N. E. 731.

text, referred to in the opinion, was never intended to have the broad application claimed for it by the attorneys for the "surety company" in the case above referred to. It must be admitted without question, that the payment of the premium may be, of course, waived by the insurer. It may be further observed that the insurer may estop itself by its acts from claiming exemption from liability under a policy, either on account of the failure of the insured or the "risk" to pay the premium or on account of the absence of any promise to pay a premium to the insurer, running either from the insured or the "risk" or from a third party. The ordinary rules of law applicable to the subject-matter of consideration of contracts apply to guaranty insurance contracts the same as they do to ordinary commercial contracts. Thus, in line with the decision of the Washington Supreme Court in the case cited above, it may be said that where an insurer delivers a bond guaranteeing the acts of a designated "risk," the insured may assume that the premium has been paid to the insurer and cannot afterwards be heard to say, as against the insured who has parted with value relying thereon, that the premium has not been paid. The original consideration that existed for the making of the contract between the insured and the "risk," the proper performance of which is guaranteed either in whole or in part by the issuance of a policy of guaranty insurance, is sufficient in itself to sustain such policy, as against the "surety company" which issued it. That is, a consideration from the insured moving to the "risk" alone (as, for example, the granting of employment by the insured to the "risk" in consideration of the issuance to it of a fidelity bond) is sufficient in law to sustain the binding obligation of such policy.[1] Of course, in the absence of any of the elements of estoppel such as would forbid the surety company insisting on the validity of a condition in a policy of guaranty insurance issued by it, to the effect that the same would not be valid

[1] See Pacific Nat. Bank of Tacoma *v.* Ætna Indemn. Co., 33 Wash. 428; 74 Pac. 590.

unless the premium thereon had been paid, such a condition would unquestionably be sustained by the court.[1] Where a bond of indemnity does not stipulate how long it shall remain in force, or covenant that so long as it shall so remain the "surety company" issuing it should be paid an annual premium so as to continue the bond in force, but leaves the insured at liberty to decline to make payments, it may thus put an end to the contract in so far as the rights of third persons are not affected.[2]

In conformity with the foregoing principle it has been held that where a bonding company, with knowledge of the informality in the execution of a bond by its agent, receives and retains the premium paid for the bond, it is estopped in an action on the bond from urging such informality as a defence.[3]

§ 199. **Conditions Precedent to the Maintenance of a Continuous Liability under the Policy.** — The following may be enumerated as the principal provisions of contract insurance policies in the nature of conditions precedent to the maintenance of a continuance liability under the policy.

(A) Condition requiring the insured to give the insurer notice of commencement of work by the risk.

(B) Condition that all moneys due on the contract from the insured to the "risk" shall be disbursed by the insurer.

(C) Condition to the effect that a certain proportion of the payments on the contract covered by the insurance due from the insured to the "risk" shall be retained by the insured until some designated person, usually an architect or engineer, shall certify that the work has been performed according to contract and all material and labor claims have been paid.

§ 200. (A) **Condition Requiring the Insured to give Notice of Commencement of Work by the "Risk."** — Frequently

[1] Batson *v.* Fid Mut. Life Ins. Co., Ala. ; 46 Sou. 578.

[2] Fid. & Dep. Co. *v.* Libby, 72 Neb. 850; 101 N. W. 994.

[3] Farmers & Merch. Ins. Co. *v.* U. S. Fid. & Guar. Co., Neb. ; 108 N. W. 156; Roark *v.* City Tr., Safe Dep. & Sur. Co., Mo. App. ; 110 S. W. 1.

contract bonds provide that in order to entitle the insured to recover thereon, the latter must give notice immediately to the insurer as to the "risk's" having commenced work under the contract, the faithful performance of which the bond was intended to secure. Such condition is unquestionably valid, and failure to give immediate notice of the commencement of the work will relieve the insurer from liability on the bond.[1]

§ 201. (B) **Condition that all Moneys due on the Contract from the Insured to the "Risk" shall be disbursed by the Insurer.** — So long as the parties to the contract see fit for the protection of the insurer to make as a condition to the furnishing of the bond that all moneys due from the insured on the contract covered by the bonds shall be disbursed by a certain designated party, such a condition is to be regarded as a valid one and must be substantially complied with in order to hold the insurer upon the bond.[2]

§ 202. (C) **Condition to the Effect that a Certain Proportion of the Payments on the Contract covered by the Insurance Bond due from the Insured to the "Risk" shall be retained by the Insured until some Designated Person, usually an Architect or Engineer, shall certify that the Work has been performed according to Contract and that all Material and Labor Claims have been paid.** — The decisions are by no means uniform as to the effect of payments made by the insured to the "risk" in violation of conditions of the policy of contract insurance, forbidding the making of such payments until certain evidence, of a designated character, has been submitted, showing that the contract insured has been duly performed and that all labor and material claims have been paid. One line of cases is to the effect that such a condition is for the benefit of the insured alone.[3] These cases

[1] Orleans & J. Ry. Co., Ltd. *v.* Nat. Sur. Co., *et al.*, 113 La. 409; 37 Sou. 10.

[2] Am. Bond. & Tr. Co. *v.* Takahashi, *et al.*, 111 Fed. 125; see also Van Buren Sur. Co. *v.* Am. Sur. Co., Ia. ; 115 N. W. 241.

[3] See City of Madison *v.* A. S. E. Co., 118 Wis. 480; 95 N. W. 1097; Hipwell *v.* Nat. Sur. Co., Ia. ; 105 N. W. 318.

are to the effect that payments made by the insured to the "risk" prior to the full performance of the latter's contract do not have the effect in law of relieving the surety company from liability on its bond.[1]

In Spokane *v.* Costello,[2] the Washington Supreme Court held that where the insured (a city) was not required by contract to withhold any payments from the "risk," but the contract simply provided that the Board of Public Works might withhold such sum as it deemed necessary, that then in such case payments so made will not in absence of proof of fraud or collusion on the part of the board, serve to relieve the insurer from liability. In arriving at this conclusion the court spoke as follows:

"The question of the release of the surety presented by the second branch of the contention is of more difficulty, but we think the ruling of the court was correct upon it also. The cases cited as maintaining the contrary doctrine are distinguishable from this case in the fact that the contracts there under consideration expressly made it the duty of the owner to withhold out of the contract price a specified sum until the final settlement between the parties, and the release of the surety was based on the fact that payment of the entire contract price had been made after the owner had notice that claims were made against his property for which the contractor was primarily liable. In other words the payment was made in violation of the express terms of the contract. But here the facts are different. It will be noticed from the quotation made from the contract that the city was not required to withhold any fixed sum; but it is provided that if in the judgment of the Board of Public Works it shall be necessary to retain a portion of the contract price, the city may retain such amount as the Board may deem necessary. The Board of Public Works therefore was made by the contract the judge of the necessity of retaining any

[1] See McNally *v.* Merc. Tr. Co., 204 Pa. St. 596; Atl. ; Trustees of Baptist Church, 31 Ky. L. Rep. 520; 102 S. W. 325; Fid. & Dep. Co. of Md. *v.* Robertson, overruled in First Nat. Bank *v.* Fid. & Dep. Co., 145 Ala. 335; 40 Sou. 415; 136 Ala. 379; 34 Sou. 933; U. S. Fid. & Guar. Co. *v.* Omaha Bldg. & Con. Co., *et al.*, 116 Fed. 143; Leghorn *v.* Wydell, 39 Wash. 17; 80 Pac. 833; Phila. to Use of McLinden *v.* U. S. Sur. Co., 11 Pa. Dis. 128; Spokane *v.* Costello, 42 Wash. 182; 84 Pac. 183; Degnon-McLean Co. *v.* City Tr., Safe Dep. & Sur. Co., 99 N. Y. App. Div. 195.

[2] 42 Wash. 182; 84 Pac. 183.

portion of the contract price, and their conclusion as to the necessity, in any given case, must bind the city and the surety alike unless it be shown that there was fraud on the part of the board or collusion between it and the party in whose favor the decision was made. Neither fraud nor collusion was alleged or proven. The presumption therefore is that the Board of Public Works acted in good faith and in accord with the best judgment in making the final payment, and this being true, the surety cannot claim a discharge because of that act."

A somewhat different but equally important question as any presented in the foregoing cases is to be found in American Surety Company *v.* Board of Commissioners of Waseca County, *et al.*[1] Here a municipality was given a bond by a contractor for public work and labor performed and for materials furnished as they became due. It was held that such municipality had no right to withhold payments to the contractor, as such payments had been stipulated for and agreed upon in the contract, on the ground that the contractor was in default with his labor and material-men. Having no such right, the municipality, it was said, is not disregarding its duty to a surety upon the bond when making payments in accordance with the terms of the contract, though previously notified of the default by such surety. The Minnesota Supreme Court in passing upon the question said:

"The municipality is not a trustee for the purpose of enforcing a liability accruing to other parties through the delinquency of the contractor, for by express provision this right rests with the injured party. . . . The parties for whose benefit and protection the obligation is entered into are as independent of each other under the law as if separate bonds had been required and given. . . . While it is the law that a creditor or an obligee upon a bond must deal fairly with a surety, he cannot be held to have dealt unfairly if he has simply complied with the terms of his contract and has been powerless to do otherwise. The 'board' had no authority under the statute to enforce the contractor's duty towards the laborers and material-men by withholding payments on the estimates and consequently it neglected no duty to the surety."

[1] 77 Minn. 92; 79 N. W. 649.

Finally, it should be observed that it is of course at all times within the power of the insurer to waive either expressly or by necessary implication the benefit of any such stipulations in the policy as the one now under consideration.[1]

Let us turn now to the second line of cases referred to above. These hold that the conditions here referred to are for the benefit of the insurer as well as the insured and are to the effect that payments shall not be made by the insured to the " risk " until the contract is faithfully performed as provided in the policy, and that any material breach of such condition will serve to relieve the insurer from liability under its policy to the extent of such payment. As an example of this line of cases attention is called to Electrical Appliance Company *v.* United States Fidelity and Guaranty Company.[2] Here it was held that where the policy provided that the insured, before making final payments on the contract price to the " risk," should present receipts in full for labor and material, and the insured paid the " risk " without requiring such receipts, such conduct had the effect in law of relieving the insurer from liability under the policy to the extent of claims unpaid by the " risk." " That this stipulation," it was said, " was of importance to the surety admits of no doubt. No successful attempt can be made to resolve the undertaking of the surety into different factors and say that they are independent and one subsists for the benefit of the plaintiff, and another may fail because of the conduct of the assured. So far as this case is concerned, the obligation of the surety is a unit, and no liability can be predicated thereon except in accordance with the terms of the contract." In the case of the United States to the Use of Heise, Bruns and Company *v.* American Bonding and Trust Company[3] the court spoke as follows:

"When the rights of sureties are involved, they are bound only by the contract which they have signed, and have a right to look to

[1] See Enterprise Hotel Co. *v.* Brook, *et al.*, 48 Ore. 58; 85 Pac. 333.

[2] 110 Wis. 434; 85 N. W. 648.

[3] 89 Fed. 925; 32 C. C. A. 420.

a literal and strict construction of the same, and not that such contract shall be extended either by implication or as a consequence of what others may do in matters of which they have no notice and with which they are not connected. . . . A surety is bound by the terms of his contract, and if a creditor, by agreement with the principal debtor without the concurrence of the surety, varies its terms by the enlargement of the time of performance the surety is discharged."

In this particular case certain material-men furnished materials to a government contractor. The latter, from time to time, paid them sums of money, which was employed by them without notice to the "surety company" in paying a prior indebtedness of the contractor covered by the bond, running to a period later than the date set for the completion of the contract, and until after the contractor had become insolvent. It was held, that as to the "surety company" the material-men were bound to apply such payments on the indebtedness arising under the government contract and the failure to do so relieved it from liability *pro tanto*.

In arriving at this conclusion, the court called attention to the fact that the insured knew of the existence of the policy and upon the faith thereof furnished material and sold the same upon the understanding that they were to be paid for their material as the money was received by the "risk"[1] from the government. They thus knew of the situation in which the insurer was, while the latter did not know that materials were being furnished to the "risk" by the insured on account of this work. It would be manifestly unjust and unfair, it was said, to require the insurer to make good to the insured a debt that would have been worthless but for the application thereto of money received from the government, which might have been applied to the payment of the debt for which the insurer was bound under the policy.

In First National Bank *v.* Fidelity and Deposit Company[1] the court spoke as follows:

[1] 45 Ala. 335; 40 Sou. 415.

"It is a maxim of the law that all parties, whether principal or surety, who reduce their contracts to writing, have a right to insist upon the terms of the contract as written, and it does not lie in the power of the courts to say that although a party has contracted to do one thing, and yet he has done something else which is more beneficial to the other party, he is therefore entitled to the enforcement of the contract. When a party enters into a contract to do certain work and on certain terms and procures a surety to guaranty the faithful performance of the work, the surety necessarily contracts with reference to the contract as made. The terms of the contract become a part of the terms of the bond. Otherwise the surety could never know what obligation he had assumed. The contracts are made at the same time. The surety bond recites, that 'Whereas, a building contract has been made, etc.' Then in the absence of any explicit declaration to that effect it is difficult to see how the court can undertake to say that certain provisions are made for the benefit of the principal alone and cannot be waived or changed by him without the consent of the surety. The case of Fidelity and Deposit Company of Maryland *v.* Robertson,[1] in so far as it conflicts with this opinion, has been overruled.

"While as between the original parties to the contract, either party may waive any of its provisions, yet, when a third party becomes interested in the contract, by binding itself to its faithful execution, the contract becomes a part of his obligation, and its provisions cannot be waived so as to affect his interest without his consent. We hold that under the contract and bond in this case, which constitutes one transaction, if the plaintiff did not pay for the work and material in manner provided by the contract, but instead thereof, by arrangement made either at the time the contract was made or afterwards with the contract or without the consent of the surety, and permitted the contractor to overdraw his account, so that considerable amounts of money were paid to him, but no certificates were issued by the architect, and the material was paid for without any estimate and before delivery and without any regard to the retention of the percentage, trusting to the certificates and estimates to be credited on such general account, then this was such a departure from the terms of the original contract as to release the obligation of the surety."

A statement of the rule enunciating the legal effect of such breaches of condition as are now under consideration, as contained in the second line of cases herein referred to, contains,

[1] 136 Ala. 379; 34 Sou. 933.

it is believed, not only the prevailing, but the true rule that should govern in such cases.[1]

§ 203. **Conditions by way of Absolute Limitation of the Liability of the Insurer to the Insured under the Policy.** — The foregoing absolute limitations to which reference is here made may be enumerated as follows:

(A) Conditions limiting the liability of the insurer to the insured to acts of the identical "risk" named in the policy at the time the same was issued.

(B) Conditions limiting the right to enforce the liability of the insurer under its policy of contract insurance to the identical party or parties named as the insured in the policy at the time the same was written.

(C) Conditions limiting the liability of the insurer to the insured to breaches only of a valid contract previously entered into between the "risk" and the insured, and the faithful performance of which is secured by the policy of contract insurance.

(D) Conditions limiting the liability of the insurer to the insured to losses occurring through the personal acts of the "risk" and not arising by act of God.

(E) Conditions excepting the insurer from liability under the policy in all cases where there has been any substantial change in the contract entered into between the insured and the "risk" and the faithful performance of which is guaranteed by the policy of contract insurance.

§ 204. (A) **Condition limiting the Liability of the Insurer to**

[1] See Shelton *v.* Am. Sur. Co., 131 Fed. 210; Nat. Sur. Co. *v.* Long, Ark. ; 107 S. W. 384; Maneely *v.* City of N. Y., 105 N. Y. 976; 119 App. Div. 376; Alcatraz Masonic Hall Ass. *v.* Fid. & Guar. Co., 3 Cal. App. 338; 85 Pac. 156; Lucas *v.* Ætna Indemn. Co., 32 Pa. Sup. Ct. 148; Folz *v.* Amweg & Merc. Tr. Co., 191 Pa. 157; Hipwell *v.* Nat. Sur. Co., 130 Ia. 656; 105 N. W. 318; City of Madison *v.* A. S. E. Co., 118 Wis. 480; 95 N. W. 1097; Fid. & Dep. Co. *v.* Agnew, 152 Fed. 955; Phila. to Use of McLinden, 205 Pa. 172; 54 Atl. 719; Dolan *v.* Tr. Co., 139 N. C. 212; 51 S. E. 924; Shelton *v.* Am. Sur. Co., 127 Fed. 763; same case, 131 Fed. 210; Enterprise Hotel Co. *v.* Brook, *et al.*, 48 Ore. 58; 85 Pac. 338; J. C. W. Supply Co. *v.* Met. Cons. Co., (N. J.) ; 69 Atl. 1088.

the Insured to Acts of the Identical "Risk" named in the Policy at the Time the Same was issued. — The rule cannot be stated too strongly to the effect that any change in the personnel of the "risk" after the contract bond has been issued will serve to relieve the surety company issuing the same from all liability thereunder. The reason for the foregoing statement is obvious. The "surety company" might be entirely willing to furnish a contract insurance bond for A acting independently, when it would be entirely unwilling to furnish such bond were A to act in conjunction with B.[1] However, it must be admitted that the courts have not at all times given to changes in the personnel of the "risk" named in a contract insurance bond their proper legal effect.[2]

It is, however, clear that if a change is made in the personnel of the "risk" and the insurer, after knowledge thereof, makes no formal objection thereto, it will thereafter be estopped from claiming discharge from liability under its bond on the ground of having waived its rights in the premises thereby.[3]

§ 205. (B) **Conditions limiting the Right to enforce the Liability of the Insurer under its Policy of Contract Insurance to the Identical Party or Parties named as the Insured in the Policy at the Time the Same was issued.** — It would appear as a principle well recognized in general insurance law, that the personality of the insured should not be capable of change excepting with the express or implied consent of the insurer. The true rule is well stated in Citizens Trust and Surety Company *v.* Howell,[4] as follows:

[1] Friendly *v.* Nat. Sur. Co. of N. Y., *et al.*, Wash. ; 89 Pac. 177.

[2] See Mut. Bldg. & Homestead Ass. *v.* Fid. & Dep. Co., 50 La. 291; 23 Sou. 405; Zane, *et al.* *v.* Cit. Tr. Co., 111 Fed. 84; City of Milbank *v.* Western Sur. Co., S. D. ; 111 N. W. 561; U. S. to the Use of the Standard Oil Co. *v.* City Tr., Safe Dep. & Sur. Co., 21 App. D. C. 369; City Tr., Safe Dep. & Sur. Co. *v.* U. S. to the Use of Bryant, *et al.*, 147 Fed. 155; Sachs, *et al.* *v.* Am. Sur. Co., 76 N. Y. Sup. 335; U. S. *v.* Hegeman, 21 Pa. Sup. Ct. 459.

[3] Crowley *v.* U. S. Fid. & Guar. Co., 29 Wash. 268; 69 Pac. 784; see also Nat. Sur. Co. *v.* T. B. T. Br. & Con. Co., 176 Ill. 158; 59 N. E. 938.

[4] 19 Pa. Sup. Ct. 255.

"We fully recognize the principle that as the surety can only be charged when the case is brought within the very term of his contract, the obligee cannot be permitted without the assent of the surety to enter into any arrangement which has the effect of varying the terms of the contract and extending or enlarging the liability of the surety, or which deprives him of the benefit he contemplated from the character, credit and substance of the person, whether natural or artificial, with whom he contracted. But we do not think it is to be assumed that the effect of the assignment alleged in plaintiff's statement was to permit the obligee to drop out and to substitute another obligee in its stead. The averment as to the assignment is to be read in the light of the averments as to performance by the original obligee. So construed it is not to be implied on demurrer that the assignment deprived the Citizens Company of the right and liability to perform the condition of the bond, even though it may be conceded, which is by no means clear, that it was made before breach. Nor is it to be implied that as between the Citizens Trust Company, the original obligee, and the Union Surety and Guaranty Company, the use plaintiff, the former was relieved of the duty to perform. So far as we are at present informed there was no alteration or variation of the terms of the contract and no extension or enlargement of the liability of the surety. We conclude, therefore, that it was error to hold that the surety was discharged." [1]

§ 206. (C) **Conditions limiting the Liability of the Insurer to the Insured to Breaches only of a Valid Contract previously entered into between the "Risk" and the Insured, and the Faithful Performance of which is secured by the Policy of Contract Insurance.** — It has already been seen[2] that policies of contract insurance are invariably entered into for the purpose of securing the faithful performance of a collateral

[1] See for a full discussion of the question of the right of the insured to assign a contract insurance bond, § 172, *ante;* see also S. B. & L. Co. *v.* La Sassier, *et al.*, 106 La. 389; 31 Sou. 7; Hardison & Co. *v.* Yeaman, *et al.*, 115 Tenn. 639; Herpolisheiner *v.* Hansell-Elcock Co., 141 Mich. 367; 367 N. W. 671; Quarries Co., Ltd. *v.* Fid. & Guar. Co., 78 Vt. 445; 63 Atl. 581; see Am. Bond. & Tr. Co. *v.* B. & O. S. W. Ry. Co., 124 Fed. 866; U. S. *v.* Hegeman, 21 Pa. Sup. Ct. 439; Buffalo Forge Co. *v.* Cullen & Stock Mfg. Co., 105 Mo. App. 484; 79 S. W. 1024; Board of Education of City of St. Louis *v.* Nat. Sur. Co., 183 Mo. 166; 82 S. W. 70; Sachs, *et al. v.* Am. Sur. Co. of N. Y., 76 N. Y. Sup. 335; 72 App. Div. 60.

[2] *Ante,* § 174.

contract previously entered into between the proposed "risk" and the insured. It follows as a necessary corollary to the foregoing that if such collateral contract is invalid for any reason, then such invalidity will serve as a legal bar to the enforcement of any liability on the policy of contract insurance issued in connection therewith in favor of the insured against the insurer.[1]

§ 207. (D) **Conditions limiting the Liability of the Insurer to the Insured to Losses occurring through the Personal Acts of the " Risk " and not arising by Act of God.** — A case involving the condition here referred to is that of American Surety Company, *et al.* *v.* San Antonio Loan and Trust Company.[2] In this case the " risk " (a contractor) had agreed to build a house according to certain plans and specifications and had furnished to his contractee a policy of contract insurance, guaranteeing the faithful performance of his building contract. Before the house was completed the building was destroyed through no fault of the " risk." It was held that in the absence of any provision in the contract expressly exempting the " risk " from liability for loss arising through accidental causes, neither he nor his surety company furnishing the contract insurance bond in his behalf would be exempted from liability to the insured for the breach of the " risk's " contract thereby caused.

Where a contract was entered into between two parties

[1] Alcatraz Masonic Hall Ass. *v.* U. S. Fid. & Guar. Co., 3 Cal. App. 358; 85 Pac. 156; Nat. Sur. Co. of N. Y., *et al.* *v.* Kansas City Hydraulic Press Brick Co., 91 Kan. 196; 84 Pac. 1034; Shaughnessy, *et al.* *v.* Am. Sur. Co., 138 Cal. 543; 71 Pac. 70; same case, 138 Cal. 543; 69 Pac. 250; Home Sav. & Tr. Co. *v.* Fid. & Dep. Co. of Md., 115 Ia. 353; 88 N. W. 831; Kansas City Hydraulic Press Br. Co. *v.* Nat. Sur. Co., Mo. Cir. Ct. ; 151 Fed. 620; Phila. to Use of, etc. *v.* McLinden, *et al.*, 205 Pa. 172; 54 Atl. 719; see also in this connection City of Milbank *v.* Western Sur. Co., S. D. ; 111 N. W. 561; Phila. *v.* Pemberton, 25 Pa. Sup. Ct. 323; U. S. to Use of Merc. Tr. Co. of Pittsburg, 213 Pa. 411; Atl. ; Kansas City, *ex rel.* *v.* Schraeder, 196 Mo. 281; 93 S. W. 405; Ausplund *v.* Ætna Indemn. Co., 47 Ore. 10; 81 Pac. 577.

[2] (Tex.) ; 98 S. W. 387.

for the construction of a lighthouse for the United States, which provided that they should share the profits and losses equally, and declared that each party should contribute particular parts of the work, a provision that each party should be responsible for any accident or damage resulting from his neglect was held to apply only to losses occurring to third parties or to neglect or loss of the entire work by the act of God.[1]

§ 208. (E) **Conditions excepting the Insurer from Liability under the Policy in all Cases where there has been any Substantial Change in the Contract entered into between the Insured and the "Risk" and the Faithful Performance of which is guaranteed by the Policy of Contract Insurance.** — It will be found upon a careful examination of the authorities that the attitude of the courts in passing upon the question now before us is determined very largely by the canons of construction applied by that particular court to the case before it. In other words, if the *strictissimi juris* rule is held applicable to such contracts, then it will be found that the court applying such rule will invariably solve doubtful questions of law in favor of the insurer and against the insured. On the other hand, if the particular court takes the view that the canons of construction applicable to ordinary insurance contracts are equally applicable to contract insurance bonds, then it will be found that all doubtful questions of law arising out of the construction of the contract before the court will be construed in favor of the insured and against the insurer. There can be but little doubt at this day as to which rule of construction should be applied. Contract bonds furnished by the surety companies are contracts of insurance in their form when their substance is ordinarily prescribed by the statute. Therefore, the wording and contents being left entirely in the hands of the insurer for preparation, the same rules of construction should be applied as are held applicable to ordinary contracts of insurance. However that may be, the general

[1] U. S. to Use of Rowland & Guerber, *et al.*, 124 Fed. 823.

rule may be stated to be firmly established by the weight of authority in this country, to the effect that any material change made in the contract entered into between the "risk" and the insured without the consent of the surety company issuing the contract insurance bond, guaranteeing the faithful performance of such contract, will serve to relieve such surety company from all liability under its bond.[1]

In Chesapeake Transit Company *v.* Walker and Son[2] a surety company on a contract bond for the construction of a railroad for a lump sum (which contract the "risk" wholly failed to perform) was held to be discharged from liability thereunder by the making of a new contract by the insured, which, as a whole, differed materially from that on which the surety company was bound. The court in its opinion in this case spoke as follows:

"The sole question is, was the alteration material? And if the answer is in the affirmative, it is then for the surety to decide whether he is willing to be bound by a contract to which he did not agree. Of course, he may waive the defence if he chooses, but, if he declines to submit to the changed agreement, he is discharged from the original obligation. It is, perhaps, more exact to say that the original obligation does not become effective, so far as the surety is concerned, because a substantially new obligation has been substituted therefor, and that no recovery can now be had against the surety upon either; not upon the first, because the parties have in effect abandoned it; and not upon the second, because to this the surety did not agree. While the present suit does not arise in precisely this way, the situation is so closely analogous that the legal principles just referred to are still pertinent. The defendant here agreed as surety that a cer-

[1] See House *v.* Am. Sur. Co., 21 Tex. Civ. App. 590; 54 S. W. 303; U. S. to the Use, etc. *v.* McIntyre & Fid. & Dep. Co., 111 Fed. 590; Orleans & J. Ry. Co., Ltd. *v.* Nat. Sur. Co., *et al.*, 113 La. 409; 37 Sou. 10; Blanchard *v.* F. & C. Co. of N. Y., 21 Pa. Sup. Ct. 370; Nat. Sur. Co. *v.* Long, Ark. ; 96 S. W. 745; Van Buren Sur. Co. *v.* Am. Sur. Co., Ia. ; 115 N. W. 241; City of Middletown *v.* Ætna Indemn. Co., 97 N. Y. App. Div. 341; First Nat. Bank *v.* Fid. & Dep. Co., 145 Ala. 335; 40 Sou. 415; Leppert *v.* Flagg & U. S. Fid. & Guar. Co., 101 Md. 71; 60 Atl. 450; Am. Bond. Co. *v.* Regents of Univ., 11 Ida. 163; Mich. S. S. Co. *v.* Am. Bond. Co., 104 N. Y. App. Div. 347.

[2] 158 Fed. 850.

tain contract should be carried out as a whole by his principals; there was a complete failure to fulfil on the part of the principals; and, by their default, the surety became immediately bound to make good whatever damage the other contracting party might suffer in an effort to have this particular engagement carried out as a whole by other persons. But, concededly, the first agreement to which alone the engagement of the surety referred, was neither undertaken nor actually fulfilled by the second contractor. A new agreement was entered into differing in many particulars from the first; and manifestly, therefore, the surety cannot be affected by what was done under the second contract, to which he did not agree, unless the differences between the two agreements are differences in detail merely, and do not go so far as to make material and substantial changes."

A most instructive case on this immediate subject is that of Michigan Steamship Company *v.* American Bonding Company.[1] The facts therein briefly stated were as follows: "The owners of a steamship chartered it for a period of five years from the date of the first loading of the said vessel by a charter party executed October 16, 1902, which provided that the owner should forthwith, upon the execution of the contract, convert the steamship into a tank steamer, and that the work of conversion should be completed on or before March 12, 1903, and on or before which date also it was agreed the said steamer should enter the service of the charterer."

The complaint in an action brought by the owner of the steamship against the surety, upon the bond given by the charterer to secure the faithful performance by the latter of the provisions of the charter party, alleged that after the execution of the charter party the plaintiff proceeded to convert the steamship into an oil tank and that, while the work of conversion was in progress, the charterer requested the plaintiff not to press the conversion and informed the plaintiff that it would not be ready to enter upon the performance of the contract in the month of March, 1903; that thereupon it was understood between the plaintiff and the charterer that

[1] 104 N. Y. App. Div. 347; 93 N. Y. Sup. 805.

no hire should be charged the charterer by the owner during the period between March 12, 1903, and the time when the steamer should be ready for delivery to the charterer; that while the steamship was being converted the plaintiff notified the charterer that it was ready to enter upon the execution of the charter party ; that during the month of November, 1903, the charterer notified the plaintiff that it would be unable to use the steamship during the month of January, 1904; that thereupon the plaintiff, with the consent of the charterer, chartered the steamship for other purposes; that about the month of March, 1904, the charterer notified the plaintiff that it would be unable to use the steamship at all; that thereupon the plaintiff, with the consent of the charterer, chartered the steamer to another party for the balance of the period specified in the charter party and that the defendant consented to such recharter. Upon the foregoing facts the court made the following holdings:

First. That it was the intention of the parties to the charter party that the period over which the contract was to extend was to commence at the date of the first loading of the steamship or on March 12, 1903, if she was not loaded before.

Second. That under the contract, the plaintiff was bound to have the steamship ready to enter the service of the charterer on or before March 12, 1903.

Third. That when, prior to March 12, 1903, the charterer notified the plaintiff that it would not then be ready to fulfil the contract, there was a breach of the contract by the charterer which would have justified the plaintiff in at once treating such notification as a breach of the contract.

Fourth. That the fact that the plaintiff, after such notification, agreed that no hire should be exacted of the charterer between March 12, 1903, and the time when the steamship was ready for delivery, did not, independent of whether or not such agreement was founded upon a sufficient consideration, operate as a modification of the contract for the reason that there was no agreement between the parties that the

steamship should not be ready for the charterer on March 12, 1903, or that the commencement of the term of the charter should be postponed until the steamship was actually in the possession of the charterer.

Fifth. That consequently, the complaint was not demurrable on the ground that it showed a modification of the contract which would discharge the surety from liability under the rule that a surety is discharged by any alteration of the contract to which his guaranty applies whether the alteration is or is not material or injurious to him.

Sixth. That a mere agreement between the parties to a contract that one of them will not enforce a breach of the contract is not a modification of the contract which will discharge the surety of the party guilty of the breach.

Seventh. That averments in the defendant's answer to the effect that after the charterer had been guilty of a total breach of the charter party, the plaintiff rechartered the steamer so as to reduce as much as possible the damages which the defendant was called upon to pay, did not constitute a defence.

Eighth. That averments in the defendant's answer to the effect that after the execution of the bond by a binding agreement between the charterer and the plaintiff, without the knowledge or consent of the defendant, the charter party was altered in important respects; that the time fixed by the charter party within which the said steamship should be converted into an oil tank and within which she should enter the service of the charterer was changed and enlarged, and that, in pursuance of said agreement, the steamship was not converted into an oil tank, on or before March 12, 1903; and was not tendered until many months thereafter, constituted a complete defence to the plaintiff's cause of action.

Ninth. That averments in the defendant's answer that the plaintiff did not use proper diligence to recharter the steamship did not constitute a complete defence, although they might possibly be sufficient as a partial defence.

As a broad general principle it may be said that the law of insurance forbids that there shall be such dealings between the "risk" and the insured of which the insurer is kept in ignorance, as shall put the latter in a position of peril. It seems but reasonable, that if the insured designedly acts in the manner just indicated, it should be held to have released the insurer and to have elected to look solely to the "risk."[1]

The courts do not seem to agree as to whether or not the existence of a material alteration in the contract is a question of law or a question of fact.

Our own opinion is that where the facts are undisputed it is purely a question of law, and where the facts are in dispute, then it is a mixed question of law and fact.[2]

Notwithstanding the fact that it has been intimated in some quarters that neither an unauthorized change in the terms of the collateral contract, nor of the work to be performed thereunder will serve to release the insurer from liability under its bond, the true rule should be stated otherwise.

Thus in House *v.* American Surety Company,[3] it was held that generally under a building contract alterations in the specifications are allowable. But where, by a supplemental agreement over the protest of the surety on a contractor's bond, an additional story was to be added to a building which formed the subject-matter of the original contract, it was held that the agreement for the alteration, being such as was not in contemplation of the parties when the contract was made, discharged the surety. Where, however, alterations are made in a building contract which expressly provides for certain changes, and such changes are made conformable thereto, the surety is not discharged. The Indiana courts maintain the same doctrine, at the same time stating that the

[1] See U. S. to the Use of Heise, Bruns & Co. *v.* Am. Bond. & Tr. Co., 89 Fed. 921.

[2] U. S. to the Use of Nicola Bros. Co. *v.* Hegeman, *et al.*, 204 Pa. 438; 54 Atl. 344; Teppert *v.* Flaggs, *et al.*, 101 Md. 71; 60 Atl. 450.

[3] 21 Tex. Civ. App. 590; 54 S. W. 303.

general proposition that a material alteration in the terms of the contract, without the consent of the surety, will relieve such surety, applies to building contracts.[1]

Again in Bund's estate *v.* Fidelity and Deposit Company[2] the principle now under consideration was clearly set forth in the following language:

"It is claimed by defendant that it was released by the other changes made in the specifications without the written order of the architects, viz.: a vestibule door providing for the entrance to the main building, as was also some of the tiling, left out, and a copper roof was substituted for a glass roof. All these changes were made without the consent of the owner of the building, and without the consent of the surety. But plaintiff claims that as these changes did not materially enhance the cost of the structure the liability of the surety was not affected. The question does not depend upon whether there was an increase or diminution in dollars and cents of the contract price, but upon a change in the contract itself. If a change be made in the contract without his consent, the surety is discharged. The law is that the surety has a right to stand upon the letter of the contract, and any alterations thereof without his consent, even though designed for his benefit, will discharge him."[3]

[1] See Am. Sur. Co., *et al. v.* Lauber, *et al.*, 22 Ind. App. 326; 53 N. E. 793; U. S. to the Use of A. P. & F. Co. *v.* Nat. Sur. Co., 92 Fed. 549; 34 C. C. A. 526; Am. Sur. Co. *v.* U. S. to the Use of M. H. Co., 24 Sou. 388.

[2] 96 Md. 467.

[3] See also Chesapeake Transit Co. *v.* Walker & Son, 158 Fed. 850; Mich. S. S. Co. *v.* Am. Bond. Co., 93 N. Y. Sup. 805; 104 App. 347; Beebe, *et al. v.* Redmond, *et al.*, 35 Wash. 615; 77 Pac. 1052; U. S. Fid. & Guar. Co. *v.* U. S., 191 U. S. 416; 48 L. E. 242; U. S. for the Use of Hill *v.* Am. Sur. Co., 200 U. S. 197; House *v.* Am. Sur. Co., 21 Tex. Civ. App. 590; 54 S. W. 303; Am. Sur. Co., *et al. v.* Lauber, *et al.*, 22 Ind. App. 326; 53 N. E. 793; see also U. S. to the Use of A. P. & F. Co. *v.* Nat. Sur. Co., 92 Fed. 542; 34 C. C. A. 526; Am. Bond. Co. *v.* U. S. to the Use of M. H. Co., 24 Sou. 388; Nowell *v.* Mode, Mo. App. ; 11 S. W. 641; Fewell *v.* Am. Sur. Co., *et al.*, 28 Sou. 755; Am. Sur. Co. *v.* Woods, 105 Fed. 741; 106 Fed. 263; 45 C. C. A. 282; Am. Sur. Co., *et al. v.* Lauber, *et al.*, 22 Ind. App. 326; 53 N. E. 793; Am. Sur. Co. *v.* Choctaw Con. Co., *et al.*, 135 Fed. 48; City of New Haven *v.* Steam Economizer Co., *et al.*, 79 Conn. 482; 65 Atl. 959; Ætna Indemn. Co. *v.* Auto Traction Co., 147 Fed. 95; U. S. to the Use of Rowland *v.* Guerber, *et al.*, 124 Fed. 823; Burns Estate *v.* Fid. & Dep. Co. of Md., *et al.*, 96 Mo. Ct. of App., 469; 70 S. W. 518; Am. Sur. Co. of N. Y. *v.* Scott & Co., 18 Okla. 264; 90 Pac. 7; McKenzie, *et al. v.* Barrett, Tex.

A somewhat difficult question is introduced when the contract insurance bond itself provides that changes may be made in the contract entered into between the "risk" and the insured without thereby releasing the insurer from liability. In a recent Texas case a building contract was materially altered after the contract insurance bond guaranteeing its faithful performance was furnished.[1] In its opinion in this case the court spoke as follows:

"If the principals in a contract by agreement between themselves, without the knowledge or consent of a surety who guarantees its performance, alter the terms and conditions of the contract, the surety is thereby released. Though this provision asserts what is ordinarily a well established principle of law, it is not applicable here because the contract by its own terms reserves the right to the owner to make changes in the plans and specifications and the surety company must be held to have had this reserve right in contemplation at the time it executed the bond, and is not in a position to complain because the right was exercised. As is said in the case of Filbert *v.* City of Philadelphia, Pennsylvania,[2] 'We are not dealing with alterations in a contract, made with surety or which radically change the character of the work, but with those expressly authorized and provided for which concern only the details of construction. If the contract does not permit these it would not of course have been within the power of the contractor to make them, but we see no reason to doubt the power of the city to provide in the contract for such changes as were made and to authorize the contractor to make them.'"[3]

; 98 S. W. 229; Segari *v.* Ætna Indemn. Co., *et al.*, 116 La. 1026; 41 Sou. 245; Drumheller *v.* Am. Sur. Co., 30 Wash. 530; 71 Pac. 25; Bagwell *v.* Am. Sur. Co. of N. Y., Mo. Ct. of App. ; 77 S. W. 326; Gansevoort Bank *v.* Em. St. Sur. Co., 123 App. Div. 331; Am. Bond. Co. of Baltimore *v.* City of Ottumwa, 137 Fed. 572; Nor. Ev. Luth. Beth. Cong. *v.* U. S. Fid. & Guar. Co., *et al.*, 81 Minn. 32; 83 N. W. 487; U. S. to Use of Phœnix Iron Co. *v.* Cal. Br. & Cons. Co., 152 Fed. 559; U. S. for the Use of Hegeman, 204 Pa. 438; 54 Atl. 344; Allen Co. *v.* U. S. Fid. & Guar. Co., Ky. ; 93 S. W. 44; City of Middletown *v.* Ætna Indemn. Co., *et al.*, 106 N. Y. Sup. 374; Van Buren Sur. Co. *v.* Am. Sur. Co., Ia. ; 115 N. W. 241; Snoquahim R. R. Co. *v.* Am. Sur. Co., 179 Mo. 629; 78 S. W. 1014.

[1] Am. Sur. Co., *et al.* *v.* San Antonio Loan & Tr. Co., Tex. ; 98 S. W. 387.

[2] 37 Atl. 546.

[3] See to the same effect J. C. W. Supply Co. *v.* Met. Cons. Co., (N. J.) ; 69 Atl. 1088.

Again on this same subject, the Federal Court of Appeals for the Sixth Circuit[1] spoke as follows:

"It is claimed that the requirement to do the work according to the new plans and specifications was a material alteration of the contract, and because it was such, the construction company was released from further obligation, not only to do the work in Illinois, but also in Indiana. A material alteration of a contract is a destruction of the old provision in the matter altered, and an attempt to foist a new provision on the other party to the contract. Certainly a party to a contract is not released from an obligation to perform some provision in it because the other party has attempted a material alteration of another provision therein, when he has the power under the contract to annul that provision altogether. If he had gone further than to annul that provision altogether, no release would have taken place, but because he has gone further and attempted to substitute another provision in its place, a release takes place.

"We cannot assent to this proposition, nor do we think it makes any difference that the party is not conscious that he is making a material alteration and does not intentionally do so. The position is that because he was not consciously and intentionally making a material alteration, a release takes place. The matter should be considered from the standpoint of the ground upon which the release is claimed, *i.e.*, there has been a material alteration. Though a material alteration should otherwise be a ground of release, it should not where the party making the alteration has the power to annul the provision attempted to be altered, and that irrespective of the question whether he is consciously and intentionally making it."[2]

A state of facts somewhat unusual is to be met with in the case of Enterprise Hotel Company *v.* Burke, *et al.*[3] Here a contract for the construction of a building provided that if the owner should, during the performance of the work, request in writing any alterations, the same should be made and the value thereof should be added or deducted from the contract price. The contractor's bond provided that no departure from

[1] Am. Bond. & Tr. Co. *v.* B. & O. S. Ry. Co., 124 Fed. 866.

[2] Cleveland C. C. & St. L. Ry. Co. *v.* Moore, Ind. ; 82 N. E. 52; Snoquahim R. R. Co. *v.* Am. Sur. Co. 179 Mo. 629; 78 S. W. 1014; Getchell & Martin Lumber Mfg. Co. *v.* Nat. Sur. Co., 124 Ia. 617; 100 N. W. 556; Phila. to Use of Stewart, 201 Pa. 526; 51 Atl. 348.

[3] Ore. ; 85 Pac. 333.

the specifications or alterations of the same should operate to make void the bond. It was held that the sureties were not released from liability on the ground that the contractor consented to alterations in the work when requested, without first requiring that such requests should be made in writing, the provisions in the contract to that effect being for the benefit of the contractor.

§ 209. **Conditions Subsequent, the Performance of which is Necessary to the fixing of the Liability of the Insurer under the Policy, after the Occurrence of a Loss involving Contingent Liability under the Policy.** — The conditions here referred to may be subdivided into the following classes:

(A) Conditions relative to notice of loss.

(B) Conditions relative to proof of loss.

(C) Conditions relative to the prosecution of the "risk" after the liability is incurred.

(D) Condition relative to arbitration of the question of liability between the insured and the insurer.

(E) Condition making the certificate of the architect as to performance of the work conclusive upon the parties to the contract, the faithful performance of which is secured by the giving of the contract insurance bond.

(F) Condition limiting the liability of the insurer to the amount of penalty named in the bond.

(G) Conditions limiting the liability of the insurer to the insured with respect to suits brought for the purpose of enforcing the liability upon losses to those actions only which shall be commenced within a designated period after the first discovery.

§ 210. (A) **Conditions Relative to Notice of Loss.** — A very common provision in a contract bond is that requiring written notice of the "risk's" default within a certain specified time accompanied by a statement of the facts showing default and the date thereof. While such conditions are unquestionably valid, it should however be observed, that such notice is not due until the insured is apprised of the default, or

should have known thereof in the exercise of reasonable diligence.[1]

Frequently the policy contains a provision that the insurer shall be notified in writing of any act on the part of the " risk " which shall involve a loss for which the insurer is responsible immediately after such act shall have come to the knowledge of the insured. Sometimes the policy provides in specific terms the exact number of days within which such notice shall be given. In any event such conditions are to be regarded as valid and enforceable. In this connection attention is called to the case of United States Fidelity and Guaranty Company *v.* Rice.[2] The facts in this case briefly stated were as follows: A contract insurance bond had been given, providing for the construction of a building. It further provided that no liability should attach to the insurer issuing such bond unless the latter should receive notice from the insured of any default on the part of the " risk," promptly on knowledge thereof by the insured. The court in its opinion spoke as follows:

"The parties by clear and unambiguous language contracted that no liability should attach to the surety company unless it received notice of any default on the part of the contractor promptly, upon knowledge thereof by the owner, and in any event not later than thirty days after such default, to the end that it might avail itself, if it desired, of the opportunities furnished by the bond for protecting itself. We think that stipulation of the contract was as binding upon the owner as the obligation to pay was upon the surety company. It was a most reasonable stipulation. Its purpose was to protect the surety company from the consequences of any default, by providing that on the occasion of any default whatsoever, it might have the opportunity of determining its effect upon its own liability and of acting accordingly. It may well be that if the surety company had been notified promptly as required by the bond of the default by the contractor in failing to complete the contract by December 1, it would have assumed the completion of the building, prevented further payments by the owner to the contractor, and at least secured the sum

[1] Van Buren Sur. Co. *v.* Am. Sur. Co., Ia. ; 115 N. W. 214; Am. Bond. Co. of Baltimore *v.* City of Ottumwa, 137 Fed. 572.

[2] 148 Fed. 206.

of $2899.50, which was paid to the contractor after the default, and to that extent have diminished its own liability. However that may be, the parties contracted for no liability on the bond, unless such notice should be given. It was not given, and in our opinion that fact conclusively exonerates the surety company from liability. The time for giving the notice, at any rate the ultimatum of thirty days after any default, was from the nature of the case, intended to be and was the essence of the contract. Whether the notice should be given before the expiration of 30 days might depend upon the owner's knowledge of an existing default, and whether it was promptly given after such knowledge had been acquired might depend on many considerations and be a debatable question of fact. But obviously the surety company had a purpose in binding the owner to give notice of any default — at the latest — within thirty days thereafter. The imposition of that duty upon the owner tended to require inspection of the work by the owner, prevent indifference on his part concerning its progress and to afford the surety company an opportunity to protect itself as provided in its bond."

Where the word "immediate" is used in connection with the furnishing of notice of loss, it should be construed to require notice within a reasonable time.

"Immediate" means before the happening of other events — forthwith. A covenant to notify a surety on the default of his principal immediately is not performed by mailing a notice eleven days after the known default.[1]

A provision in a surety bond requiring notice of default to the surety, is one to be performed after the occurrence of the loss or damage for which recovery is sought, as well as a condition precedent to the maintenance of all actions, and pertains to the remedy, and is not essential to the binding force of the contract prior to default, and is not as strictly construed as conditions involving the essence of the agreement.[2]

Attention is next called to the case of Routt, *et al.* *v.* Diles.[3] Here a bond had been given to secure the performance of a contract whereby the "risk" therein named had agreed to fur-

[1] Nat. Sur. Co. *v.* Long, 125 Fed. 887.

[2] Van Buren Sur. Co. *v.* Am. Sur. Co., Ia. ; 115 N. W. 241.

[3] Col. ; 90 Pac. 67.

nish certain material and complete certain work for the insured before November 17. The bond required the insured to give the insurer immediate notice of the failure or refusal of the "risk" to do or perform any matter or thing at the time specified. It was held that notice of the "risk's" failure to perform the contract sent on the 21st of November and received on the 24th was sufficient compliance with the conditions of the bond.

It is not necessary that the insured should give notice to the insurer of every act of the "risk" which may by some remote possibility result in loss to the latter on its bond. Such a provision only requires that such notice shall be exacted when there is some reasonable certainty that the act of which notice is required shall be reasonably certain to result in liability to the insurer.[1]

Where the contract between the "risk" and the insured provides that the former shall promptly pay all labor and material claims, the remarks of the United States Supreme Court[2] are clearly in point. On this subject that court spoke as follows:

"Stress is laid upon the fact that the defendant company guaranteed that the principal obligor should promptly make payment to his material-men and that this, properly interpreted, required that the contractor should pay at once upon the maturity of the bills, and that as such bills became due October 1, 1898, the promptness guaranteed required their immediate payment. We are not impressed with the force of this contention. If the word 'promptly' has any particular significance in this connection, it is satisfied by such payment as the sub-contractor shall accept as having been promptly made; or perhaps it was intended to give him an immediate action upon the bond, in case such payment be not made with sufficient promptness. It was not intended, however, that the want of an immediate payment should be set up as a defence by the surety. As these bills are rarely paid the very day they become due, the narrow construction would destroy the principal value of the security.

"The facts of this case do not call for an expression of opinion as

[1] Ovington *v.* Ætna Indemn. Co., 36 Wash. 473; 78 Pac. 1021.

[2] U. S. Fid. & Guar. Co. *v.* U. S., 191 U. S. 416.

to whether, if an unusual credit were given, and in the meantime the principal obligor has become insolvent or the surety were otherwise damnified by the delay, it might not be exonerated, since neither of these contingencies supervened in this case, and we are remitted to the naked proposition whether the giving of a customary credit with no evidence of loss thereby occasioned, is sufficient to discharge the surety. We find no difficulty whatever in answering this question in the negative." [1]

Sometimes the contract insurance bond requires that the insured shall give immediate notice of the commencement of work under the contract by the "risk." In construing such a condition the Supreme Court of Louisiana [2] spoke as follows:

"The defence of the surety company is that it has been released from liability by reason of a change in the contract without its consent; and also by reason of the failure of the plaintiff to give notice of the commencement of work as expressly stipulated in the suretyship bond. On the latter point the bond provided that the 'surety company' should be immediately notified by the railway company of the commencement of work under the contract, and that this notice should be given by registered letter. The notice was not given except by the mailing of a letter without registration, and the testimony is that the letter was not received. The judge below held correctly, we think, that the surety company was entitled to a strict compliance with this requirement of notice, and was released by plaintiff's noncompliance therewith."

Finally, attention is called to the case of Hefferman *v.* United States Fidelity and Guaranty Company.[3]

Here a contractor's indemnity bond provided that notice of any default by the contractor must be given the surety within thirty days, and the contract provided that the hull of the vessel should be ready for machinery September 15,

[1] Pac. Bridge Co. *v.* U. S. Fid. & Guar. Co., *et al.*, 33 Wash. 47; 73 Pac. 772; City of Phila. to Use of Webster *v.* Nichols, 214 Pa. 265; 63 Atl. 886; U. S. to Use of Flaherty *v.* Am. Sur. Co., *et al.*, 127 Fed. 496; U. S. to Use of Stansted Granite Quarries Co., Ltd., 63 Vt. 508; 63 Atl. 581.

[2] Orleans & J. Ry. Co., Ltd. *v.* International Cons. Co., 113 La. 409; 37 Sou. 10.

[3] 37 Wash. 477; 79 Pac. 1095.

and completed ready for trial October 15; a notice of default in both particulars was given October 17, together with a demand that the surety complete the contract. It was held that failure to give notice of the first default within thirty days did not release the surety from liability for the demurrage charge for the non-completion of the vessel on time, since the latter cannot say how much of the demurrage would have been saved by timely notice; but the surety is not released from liability for the cost of completing the vessel where it refuses to complete the same, and where the failure to give notice of the first default did not affect the relation of the surety with reference to the second default. This for the reason that a compensated surety can only insist upon forfeiture clauses where the failure to comply therewith probably inflicts a loss on the surety.[1]

§ 211. (B) **Conditions Relative to Proof of Loss.** — It is sufficient in order to furnish substantial compliance with the condition of contract insurance bond relative to proof of loss that the insured should furnish such proof with reasonable fulness and in such form as to give to the insurer accurate,

[1] Fid. & Dep. Co. *v.* Robertson, overruled in First Nat. Bank *v.* Fid. & Dep. Co., 40 Sou. 415; 145 Ala. 335; 34 Sou. 933; 136 Ala. 379; Nat. Sur. Co. *v.* Long, 125 Fed. 887; Burr *v.* U. S. Sur. Co., 95 N. Y. Sup. 144; 107 App. 328; Borough *v.* Union Sur. & Guar. Co., 107 N. Y. App. Div. 315; Hurley *v.* Fid. & Dep. Co. of Md., 95 Mo. Ct. of App. 88; 68 S. W. 958; see generally as to notice of loss the following cases: Hipwell *v.* Nat. Sur. Co., *et al.*, Ia. ; 105 N. W. 318; Brown *v.* Levy, 29 Tex. Civ. App. 389; U. S. Fid. & Guar. Co. *v.* Rice, 148 Fed. 206; Getchel & Martin Lumber Mfg. Co. *v.* Nat. Sur. Co., 124 Ia. 617; 100 N. W. 556; U. S. *v.* Quinn, *et al.*, 122 Fed. 65; U. S. Sur. & Guar. Co. *v.* Stevenson, 27 Pa. Sup. Ct. 324; Atkin, *et al. v.* Wyandotte Coal & Lime Co., 73 Kan. 768; 84 Pac. 1040; Denny *v.* Spurr, 38 Wash. 347; 80 Pac. 541; Hefferman *v.* U. S. Fid. & Guar. Co., 37 Wash. 477; 79 Pac. 1095; Routt, *et al. v.* Diles, Col. ; 90 Pac. 67; Ovington, *et ux. v.* Ætna Indemn. Co., Wash. ; 78 Pac. 1020; Van Buren Sur. Co. *v.* Am. Sur. Co., Ia. ; 115 N. W. 241; Allen Co. *v.* U. S. Fid. & Guar. Co., Ky. ; 93 S. W. 44; U. S. *v.* Quinn, *et al.*, 122 Fed. 65; City of New Haven *v.* Eastern Paving Brick Co., 63 Atl. 517; Conn. ; U. S. Fid. & Guar. Co. *v.* Trustees of Baptist Church, 31 Ky. L. Rep. 520; 102 S. W. 325.

specific and complete information as to the nature of the liability which is sought to be imposed upon it.[1]

The question often arises as to the effect, as a matter of proof in an action upon a contract bond, of a judgment previously obtained by the insured against the " risk " named in such bond. The general rule in this connection is that where a judgment is so obtained in good faith, without fraud or collusion by the insured against the " risk " for a breach of the conditions of the contract, the faithful performance of which is secured by the bond, the surety thereon is estopped thereby from disclaiming liability to the insured in an action by the latter brought against the surety to recover under the terms and conditions of the bond for the specific acts and defaults of the " risk " which were in issue in the suit in which such judgment was obtained.[2]

On this general subject the Illinois Supreme Court in Henry, *et al.* *v.* Heldmaier [3] spoke as follows:

"It is earnestly insisted by appellants that while the decree might have been sufficient basis for a judgment against the principals on the bond, it was not sufficient as against the sureties, for the reason that they were not parties to the decree, were not bound thereby, and never had their day in court on that issue. This raises the question, To what extent a judgment against the principal may be introduced in evidence against sureties and how far it is binding against them? This has been a matter of discussion before the various courts of this and other countries, and there seems to be more or less conflict of opinion on the subject. Some courts hold that a judgment against the principal is *prima facie* evidence against the surety, but they differ as to the character of the proof required to overcome the *prima facie* case, some announcing the rule to be that to avoid the effect of the judgment, the surety must show fraud, collusion, mis-

[1] See Am. Sur. Co. *v.* U. S. for the Use of Watt, 77 Ill. App. Ct. 106; U. S. *v.* Walker, 128 Fed. 1012; Phila. *v.* Pierson, 217 Pa. 193; 66 Atl. 321.

[2] Friend *v.* Ralston, *et al.*, Wash. ; 74 Pac. 794; Gansevoort Bank *v.* Em. St. Sur. Co., 98 N. Y. Sup. 382; see also Gritman *v.* U. S. Fid. & Guar. Co., *et al.*, Wash. ; 83 Pac. 6; B. Roth Tool Co. *v.* New Amsterdam Cas. Co., 161 Fed. 709; (C. C. A. 8th Cir.).

[3] 226 Ill. 152; 80 N. E. 705.

take or payment. Others, that the surety has the right to go behind the judgment against the principal and make any defence to it which he might have made if he had been a party to the suit. Still others hold that the judgment is conclusive evidence against the surety. But the cases are distinguishable from ordinary cases in that the contract of the surety obligates him to be responsible for the result of a suit against his principal, or where he had been privy to the suit against his principal by notice and has been given an opportunity to defend himself.

"In the American and English Encyclopædia of Law, Vol. 27, p. 455, the rule is given as follows: 'It is generally held that a judgment against a principal is not conclusive, but only *prima facie* evidence against his surety to show a breach of contract and liability unless the condition of the bond makes it conclusive.'

". . . The rule seems to be well settled that a judgment against a principal upon official bonds and bonds by parties to suits and proceedings in court, or relating to the result of a suit or proceeding, is conclusive upon the surety. Whether or not the same rule applies in suits upon bonds like the one here involved, the authorities are not altogether harmonious; but we think the weight of authority and sound reasoning is in favor of the proposition that a judgment against the principal, especially where the surety has been notified and had an opportunity to defend, is *prima facie* evidence as to the amount of damages in a suit against the surety.

"In Meyer *v.* Purcell,[1] we said, 'where a person is responsible over to another and he is notified of the pendency of a suit involving the subject-matter of the indemnity, his liability will be fixed and determined by the judgment rendered therein, and notice to him will be implied where he has knowledge of the pendency of the suit and participates in the defence thereof.' From these authorities we think the rule in this state is that where the sureties have had notice of the pendency of the suit, the judgment rendered against the principal is *prima facie* evidence against the sureties."

In an action on a bond given to the city of Philadelphia by a contractor for a school building to secure subcontractors and material-men, where it appears that judgment had been entered by default against the contractor for the price of the material furnished by plaintiff, as set forth in the contract, the plaintiffs may offer in evidence the contract and the record

[1] 204 Ill. 62; 73 N. E. 392.

of the judgment against the contractor to establish the amount of their claim, without producing any independent evidence as to the market value of the work and materials furnished. Independent evidence would only be required for mistake or collusion between the contractor and the plaintiffs to defraud the surety.

In such a case defendant cannot claim that the action is premature, because the contract provided that the plaintiff was to be paid only in proportion as the contractor received his payments from the city and that 5 per cent was to be retained for a year after final payment by the city and that this time had not expired. The surety undertook and is to pay what becomes due from the contractor to the plaintiff on the former's default. The judgment against the contractor is therefore conclusive.[1]

It should be observed, however, that the record as set forth in such judgment roll must identify the "risk" either by name or description as causing the injuries complained of in the suit on the bond brought by the insured against the insurer, and it must affirmatively appear from such judgment roll that such injuries form the basis of the suit in which such judgment was obtained.[2]

§ 212. (C) **Conditions Relative to the Prosecution of the "Risk" after the Liability is incurred.** — The condition here referred to has reference solely to the prosecution through

[1] Phila. *v.* Pierson, 217 Pa. 193; 66 Atl. 321; see also U. S. *v.* Hegeman, 21 Pa. Sup. Ct. 459; Nat. Sur. Co. *v.* Coates, Ark. ; 104 S. W. 219; U. S. *v.* Walker, 128 Fed. 1012; Lake Drummond Canal & Water Co. *v.* West End Tr. & Safe Dep. Co., 142 Fed. 41; Fid. & Dep. Co. of Md. *v.* Robertson, overruled in First Nat. Bank *v.* Fid. & Dep. Co., 145 Ala. 335; 40 Sou. 415; 136 Ala. 379; 34 Sou. 933; City of Seattle *v.* Saulez, Wash. ; 92 Pac. 140; McKenzie, *et al.* *v.* Barrett, Tex. (Civ. Ct. of App.) ; 98 S. W. 229; Exposition Amusement Co. *v.* Em. St. Sur. Co., Wash. ; 96 Pac. 158.

[2] Lake Drummond Canal & Water Co. *v.* West End Tr. & Safe Dep. Co., 131 Fed. 147. As to necessity of forwarding proof of loss to the insurer in a particular manner, as, for example, by registered mail, see Routt, *et al.* *v.* Diles, Col. ; 90 Pac. 67.

a civil action of the "risk" by inserting the same as a condition to the enforcement of the insurer's liability by such insured under the terms and conditions of a contract insurance bond. It is probable that if the insured could be induced to accept a bond with such a condition inserted therein, the same would be enforced by the courts.[1]

§ 213. (D) **Condition Relative to Arbitration of the Question of Liability between the Insured and the Insurer.**—If the parties to a contract insurance bond provide that any disputes which may arise between them in reference to the subject-matter of the contract which the bond is given to secure shall be determined by a person therein named, whose decision shall be final, the parties cannot seek redress elsewhere, but must abide by the decision of such arbitrator.[2] The decision of such arbitrator is conclusive upon the parties to the arbitration in the absence of any bad faith on the part of such arbitrators. The arbitration clause applies, however, only to disputes between the parties to the contract and not to controversies arising between one of the parties named in the arbitration clause and a stranger.[3]

§ 214. (E) **Condition making the Certificate of the Architect as to Performance of the Work Conclusive upon the Parties to the Contract, the Faithful Performance of which is secured by the giving of the Contract Insurance Bond.** — The condition is frequently found in contract insurance bonds, providing that payments shall only be made to the "risk" on the architect's certificate. Such provisions are unquestionably valid, and any substantial violation thereof will serve to relieve the surety *pro tanto*.[4] However, such conditions are not enforced with unreasonable strictness. Thus, where a con-

[1] See Nousaratt *v.* Tr. Co., 14 Pa. Sup. Ct. 541; Whitehouse *v.* Am. Sur. Co. of N. Y., 117 Ia. 328; 90 N. W. 727.

[2] City Tr. & Sur. Co. *v.* Howell, 19 Sup. Ct. 55; Drumheller, *et al.* *v.* Am. Sur. Co., *et al.*, 30 Wash. 530; 71 Pac. 25.

[3] Warren-Ehret Co. *v.* Byrd, Penn. ; 69 Atl. 751.

[4] Boyce *v.* U. S. Fid. & Guar. Co. of Md., 111 Fed. 138; First Nat. Bank *v.* Fid. & Dep. Co., 145 Ala. 335; 40 Sou. 415; Gritman *v.* U. S. Fid. & Guar. Co., *et al.*, Wash. ; 83 Pac. 6;

tract with a city for a sewage disposal plant provided that payments should be made as the work progressed, on monthly estimates by two designated engineers, it appeared that such payments were made on the certificate of one engineer alone. The surety company who had given a bond guaranteeing the contract interposed such defect as a defence. It appeared that such provision was inserted in the contract for the benefit of the city alone, and that the payments so made were no greater in amount than they should have been if the certificate of both engineers had been exacted. It was held that such payments did not materially alter the contract nor affect the rights of the surety.[1] The general rule is that there can be no recovery by the insured against the insurer unless the former has a complete cause of action at the time the suit is filed. If the bond requires that the insured must see to it that all claims are audited and certified by an architect, a failure to see that such a condition is complied with will prevent the insured having a complete cause of action on the bond.[2]

There are, of course, some exceptions to the general rule, depending upon the peculiar facts they present. Thus, in a recent case, where a provision in a building contract provided that the amount of damages to be recovered in case the owner terminates the contract on account of a failure to perform

Am. Bond. & Tr. Co., *et al.* *v.* Gibson County, 127 Fed. 671; 145 Fed. 871; 76 C. C. A. 155; Drumheller *v.* Am. Sur. Co., 30 Wash. 530; Getchel & Martin Lumber Co. *v.* Peterson & Simpson, 124 Ia. 599; 100 N. W. 550; Jenkins *v.* Am. Sur. Co. of N. Y., Wash. ; 88 Pac. 1112; Board of Education of City of St. Louis *v.* Nat. Sur. Co., Mo. ; 82 S. W. 70; Allen Co. *v.* U. S. Fid. & Guar. Co., (Ky.) ; 93 S. W. 404; Merc. Tr. Co. *v.* Hensey, 27 D. C. App. 210; Am. Bond. & Tr. Co., *et al.* *v.* Gibson County, 145 Fed. 871; Getchel & Martin Lumber Co. *v.* Nat. Sur. Co., 124 Ia. 617; 100 N. W. 556; Bogwell *v.* Am. Sur. Co., 102 Mo. App. 707; 77 S. W. 327; Am. Bond. & Tr. Co. *v.* Gibson County, 127 Fed. 671; Smith & Sons *v.* Jewell, 104 Md. 269.

[1] City of Madison *v.* Am. San. Eng. Co., 118 Wis. 480; 95 N. W. 1097.

[2] U. S. Fid. & Guar. Co. *v.* Haggard, *et al.*, Ga. ; 61 S. E. 726; Am. Bond. & Tr. Co. *v.* Gibson County, 145 Fed. 871; 76 C. C. A. 155.

by the builder shall be certified by the architect, whose decision shall be binding on both parties, it was held that the certificate of the architect was not a condition of the right of action when the builder repudiates the contract and the owner sues to recover damages thereunder. The facts in this case were as follows:

"Defendant J. agreed with the plaintiff to lay all the bricks necessary in the construction of a building for a certain sum, and gave a bond with the other defendant as surety for the faithful performance of the contract. After doing a part of the work, J., wilfully and without legal excuses, abandoned the contract, and the plaintiff, after notice to both defendants, employed another person to finish the work at a cost in excess of that named in the contract and sued to recover such damages. The contract provided that if J. at any time should neglect to supply a sufficiency of labor to prosecute the work with diligence, but failed in the performance of any of his agreements, such failure being certified to by the architect, the plaintiff should be at liberty to provide such labor and deduct the cost thereof from any payments due to J. under the contract. And also that if the architect shall certify that such neglect or failure is sufficient ground for the action, the plaintiff should be at liberty to terminate the employment of J. and employ other persons to finish the work, and that if the expenses incurred by the plaintiff in finishing the work should exceed any unpaid balance due to J., then J. should pay the difference to the plaintiff; also that such costs shall be audited and certified to by the architect, whose certificate thereof shall be conclusive upon the parties. It was held that these provisions relating to the certificate of the architect did not apply in case where the plaintiff did not terminate the contract, but where the defendant, J., wholly abandoned the work, and that therefore the plaintiff was entitled to recovery without a certificate of the architect as to the cost of finishing the work."[1]

§ 215 (F) **Condition limiting the Liability of the Insurer to the Amount of Penalty named in the Bond.** — In marshalling claims against a "risk" named in a contract insurance bond, where such claims exceed in amount the penalty of the bond, the fact that certain of the claims have been purchased by one who has bound himself to indemnify the insurer against its liability under the bond does not increase the amount to

[1] Smith & Sons v. Jewell, 104 Md. 269; Atl. .

which other claimants are entitled as beneficiaries of such bond. On the other hand, for the purpose of making distribution to them, such claims must be treated as still subsisting.[1]

It goes without saying that in contract insurance the total liability that can be incurred and enforced under a contract insurance bond is limited in the aggregate to the amount named as the penalty in the bond itself.[2]

§ 216. (G) **Conditions limiting the Liability of the Insurer to the Insured with Respect to Suits brought for the Purpose of enforcing the Liability upon Losses to those Actions only which shall be commenced within a Designated Period after the First Discovery.** — Frequently there is met with in contract insurance bonds conditions to the effect that the insurer shall not be liable under the bond unless suit is brought thereon by the insured within a certain designated period after the completion of the work provided for in the contract to secure the faithful performance of which the bond is given. Such conditions when met with, will, in the absence of waiver thereof on the part of the insurer, be enforced by the court. Such conditions are reasonable, and a breach thereof constitutes a valid defence to an action to enforce liability on the bond.[4]

Attention is called in this connection to the case of Holtby *v.* Zane.[3] In this case the court sustained the validity of

[1] Am. Sur. Co. *v.* Lawrenceville Cem. Co., 110 Fed. 717; Thomas Laughlin Co., *et al. v.* Am. Sur. Co. of N. Y., 114 Fed. 627; U. S. *v.* U. S. Fid. & Guar. Co., 151 Fed. 534; City of New Haven *v.* Eastern Paving Brick Co., *et al.*, Conn. ; 63 Atl. 517; Am. Br. Co. of N. Y. *v.* Col. Tr. Co., Pa. ; 64 Atl. 532; U. S. *v.* Am. Sur. Co., 135 Fed. 78.

[2] U. S. *v.* Am. Bond. & Tr. Co., 128 Fed. 414; Am. Sur. Co. of N. Y. *v.* U. S., 123 Fed. 287; U. S. *v.* Am. Sur. Co. of N. Y., 135 Fed. 78.

[3] Beebe, *et ux. v.* Redward, 35 Wash. 615; 77 Pac. 1052; Borough *v.* Union Sur. & Guar. Co., 107 N. Y. App. Div. 315; Marshalltown Stone Co. *v.* Louis Drach Cons. Co., 123 Fed. 746; McGarry, *et al. v.* Seitz, *et al.*, 129 Ga. 296; 58 S. E. 856; McKinnon *v.* Higgins, 47 Ore. 44; Novelty Mill Co. *v.* Heinzerling, 39 Wash. 245; 81 Pac. 742; Fromme *v.* U. S. Guar. Co., *et al.*, 78 N. Y. Supp. 895; 39 Misc. 105.

[4] Pa. ; 69 Atl. 675.

such a condition as is here under consideration and spoke as follows:

"Appellant's contention is that inasmuch as it could not be known until the completion of the building what, if any, loss the plaintiff had sustained by reason of the contractor's failure to do the work, no right of action on the bond could have occurred until then, and that the limitation upon plaintiff's right to sue began to run only with the contractor's failure to make good to the appellant the excess that he had been obliged to pay for the completion of the building. This view of the case admits of but one possible breach of the building contract, — failure to pay the ascertained loss, — whereas the contract of surety contemplates several. By the terms of the latter, the right to sue must be exercised within six months after the first breach. It is only because of the difficulty plaintiff would have encountered in establishing any loss had he brought his action immediately upon the contractor's discharge that the suggestion made that the failure on the latter's part, which resulted in his discharge, was not a breach of the contract within the meaning of the parties. Whatever the failure was, if it was so serious as to justify a discharge from the work, nothing short of an express provision to the contrary could make it less than a distinct breach, as that term is ordinarily understood. The construction contended for not only disregards the plain language of the contract, but it so manifestly and seriously impairs the limitation upon the right to sue, that it is unreasonable to suppose any such effect was in contemplation of the parties. A proper construction can be given to the contract of suretyship only as the obligations which Zane assumed under the building contract are considered. One of these was to finish and complete the building within four months. The relation in which the limitation upon the right to sue stands to this provision in the building contract is too obvious to be overlooked. Considering that under the terms of the contract the loss sustained by plaintiff resulting from a breach by Zane could only be ascertained upon the completion of the building, where can there be found in either contract any suggestion of an enlargement of time for the erection of the building? The saving clause for the plaintiff is in the surety company's contract. No matter how early in the course of the work the breach might occur, there would remain at least two months beyond the stipulated period during which time the right to sue would survive, and plaintiff would have this additional period in which to complete the work. A construction which thus carries the right to sue to such definite later period would give the plaintiff all the protection which one in his situation at the time would be likely to re-

quire, and at the same time would put a reasonable limitation on the surety's liability. Under any other construction the limitation of the right to sue would be utterly valueless to the surety company, since the liability would be prolonged indefinitely by plaintiff's delay in completing the building."

Again attention is called to the case of Beebe, *et al. v.* Redward, *et al.*[1] Here an indemnity bond guaranteeing a building contract provided that actions thereon must be instituted within six months after the first breach of such contract. This called for the completion of the building in August, 1901, and the owner accepted the building upon its completion in December, 1901. It was held that the surety company issuing the bond could not claim that the right of action accrued in August and was barred six months thereafter, since the owner waived that period by accepting the building. The court in its opinion spoke as follows:

"Concerning the first of these conditions, if it were true that there was a breach of contract in the respect mentioned, it could not, in this action, be availed of by the plaintiffs. The respondents make no complaint of this breach. They have accepted the completion of the building on December 1, 1901, as performance of the contract, and cannot claim a default because of the delay, even though they were injured by it. The bond was given for the benefit of the respondents. Its purpose was to secure them the faithful performance of the contract on the part of the contractor, and whatever they choose to accept as performance is performance as between themselves on the one side and the contractor and the surety on the other. The surety therefore cannot complain of any breach of the contract which the owner waived that does not operate to its prejudice. If the breach increases his liability or causes him a loss in any manner, he can, of course, defend against such increased liability and recoup such losses, and it may be that breaches of the contract having this effect would relieve him from his liability entirely, but he cannot escape liability by the mere showing that there has been a departure in the performance from the strict terms of the contract. To relieve on this ground there must be a showing not only of departure from the terms of the contract, but that the position of the surety has been so changed thereby as to result in prejudice to him. In the case at bar there is no showing that the

[1] 35 Wash. 615; 77 Pac. 1052.

surety has been prejudiced by the failure to complete the building at the time stipulated in the contract, and as the owners for whose benefit the stipulation was inserted make no complaint because thereof, the surety cannot plead it as a bar to the right of the owners to recover for subsequent losses."

It may, however, turn out that the period of limitation so imposed under the bond is under the circumstances unreasonable, and for that reason unenforceable.[1] In a recent case it appeared that a bond securing the work of a municipal contractor provided for the premium to be paid annually, and further provided that the life of the bond should be the interval between the date of the bond and the date of the completion and acceptance of such work. The bond further provided that the contractor should give notice in writing to the insurer of such completion and acceptance. The original contract, the faithful performance of which the bond secured, required the " risk " to warrant and maintain all roofing, gutter, etc., for twelve months after the completion of the building which was to be erected by the " risk " named in the bond. The court held that the insurer's liability on the bond terminated one year after such completion. This, too, though the " risk " gave no notice thereof, and hence the insurer was only entitled to recover up to that date.[2]

§ 217. **Discharge of Liability by Performance of Contract.** — The liability under contract insurance bonds is satisfied by the performance of the contract insured against, whether such performance be attained by the " risk " or by the insurer assuming the performance of the contract upon the " risk's " default. Where a surety company assumes the contract upon which the " risk " has defaulted, it assumes all the defects of the " risk's " work, together with inferior materials used, and at the same time is entitled to all the benefits of the

[1] Ausplund *v.* Ætna Indemn. Co., 47 Ore. 10; 81 Pac. 577; McKinnon *v.* Higgins, *et al.*, 47 Ore. 44; 81 Pac. 581; West *v.* Higgins, *et al.*, 48 Ore. 619; 81 Pac. 582.

[2] Ætna Indemn. Co. *v.* Ryan, 103 N. Y. Sup. 756; 53 Misc. 614.

contract from the time of the default of the "risk," together with any sum that may be due the latter at the time the default occurred.[1]

Such conditions as the foregoing are practically found in contract insurance bonds. They are unquestionably valid, and when acted upon result in imposing full liability therefor on the part of the insurer who has taken over the completion of the work after the "risk's" default.[2]

It would appear that the insured has no right of its own motion upon the default of the "risk" to complete the building and then attempt to charge the insurer with the amount expended by it in connection with such completion.[3]

A surety company which had guaranteed a purchase money mortgage of a building and has under the terms of its contract a right to enter in order to complete the building, has no right as against the assignee for creditors of the owner and builder to collect rents while it is in possession for the purpose of completing the building. The surety's rights extend only to such delay or interference with the possession and control of the assignee as was necessary for the performance of the specific purpose of completing the building.[4]

Where a bond given by a subcontractor to a city contractor,

[1] Am. Bond. Co. *v.* Regents of Univ. of Ida., *et al.*, 11 Ida. 163; 81 Pac. 604; Cit. Tr. Co. *v.* Zane, *et al.*, 113 Fed. 596.

[2] Ladd, *et al.* *v.* Ætna Indemn. Co., 128 Fed. 298; same case, 135 Fed. 636; see to the same effect, U. S. Fid. & Guar. Co. *v.* Probst, 30 Ky. 63; 97 S. W. 405; Getchell & Martin Lumber Co. *v.* Nat. Sur. Co. 124 Ia. 617; 100 N. W. 556; Dolan *v.* Am. Bond. and Tr. Co., 139 N. C. 212; 51 S. E. 924; Folz *v.* Tradesmen's Tr. & Sav. Fund Co., 201 Pa. St. 583; 51 Atl. 379; Phila. to Use of Neil, 206 Pa. 333; 55 Atl. 1032; Internat. Tr. Co. *v.* Keefe Mfg. Co., Col. ; 91 Pac. 915; Nat. Sur. Co. *v.* Coates, Ark. ; 104 S. W. 219; Am. Bond. Co. *v.* Regents, etc., 11 Ida. 163; Wood *v.* U. S. Fid. & Guar. Co., 143 Fed. 424; City of Madison *v.* A. S. E. Co., *et al.*, 118 Wis. 480; 95 N. W. 1097; Lindsay *v.* Union Sur. & Guar. Co., 199 Pa. 296; 48 Atl. 1080; McNally *v.* Merc. Tr. Co., 204 Pa. 596; 54 Atl. 360; Ger. Am. Tit. & Tr. Co. *v.* Campbell, 184 Pa. 541; 39 Atl. 291; Allen Co. *v.* U. S. Fid. & Guar. Co., 29 Ky. L. Rep. 356.

[3] Zane, *et al.* *v.* Cit. Tr. Co., 117 Fed. 814.

[4] Lindsay *v.* Union Sur. & Guar. Co., 199 Pa. 296; 48 Atl. 1080.

gave the surety no opportunity on default of the subcontractor to complete the work, but by its terms the contractor was given such right, it was held that the surety in an action on the bond by the contractor, after default by the subcontractor, could not allege as a defence that it was given no opportunity to complete the work.[1]

Finally, attention is called to the case of the City of Madison *v.* Engineering Company.[2] Here a contract by an engineering company to construct a sewage purification plant stipulated that the company should operate the works for three months after their completion at its own expense, and if at the expiration of that time the plant was working " to the satisfaction of the city engineers," the city should operate the same for nine months before accepting the same. The contract then proceeded to specify the degree of purification which the company contracted to produce when the plant was working to its full capacity. It was held that this did not mean that the city was bound to accept the plant after three months and give it nine months' trial if it was mechanically fit for operation at the end of three months, irrespective of the manner in which it performed the work, but the city might refuse it, if it did not, in fact, purify the sewage.

The engineers, it was said, could not affect the rights of the city by expressing their satisfaction in the working of the plant, after their report showed that it failed to give certain guaranteed results, though they believed in time it would accomplish such results. In the case here referred to, the contract for the construction of a purification sewage plant for a city provided that if the plant failed to operate as agreed, the city should have the use of the plant, free of cost, for one year. After its refusal to accept the same, the plant was to be operated three months by the company after completion, and if it operated satisfactorily to the city engineers, the city was to operate it nine months before final acceptance. On

[1] McNally *v.* Merc. Tr. Co., 204 Pa. 596; 54 Atl. 360.
[2] 118 Wis. 480; 95 N. W. 1097.

September 28, 1899, the company tendered the plant to the city for the nine months' trial, and on the report of the city engineers the tender was refused, and on January 12, 1900, the company ceased operating the plant. The city engineers reported this fact and that the plant was not giving satisfaction, whereupon the city, by resolution, reciting the facts and the necessity of disposing of the sewage, but disclaiming any acceptance, took charge of and operated the plant for about a year until another could be constructed. The court held that under the condition for a year's use under the contract and the necessity of the occasion, the act of the city was not an acceptance, and did not affect its rights to recover on the bond given by the company for the faithful performance of the contract. Where a city contracted for a complete sewage purification plant, guaranteed to produce certain results, and the plant as an entirety was a failure and did not dispose of the sewage with the guaranteed results, there was occasioned thereby, it was held, an entire failure of consideration, notwithstanding some parts of the plant performed their work satisfactorily.

§ 218. **Discharge of Liability by Release of Securities.** — The general rule is that where the insured holds securities from the " risk " in the way of indemnity against loss through acts of the latter, the release of such securities by the insured must insure to the benefit of the insurer in any action to enforce the latter's liability on its bond.[1]

On the subject now before us the Iowa Supreme Court in Read *v.* American Surety Company[2] spoke as follows:

" A creditor does not release the surety by enforcing his claim as against the principal unless he fails in some duty assumed to the surety by the contract expressed or implied, or fails to take the proper steps on being notified by the surety to sue as provided by statute, or fails

[1] U. S. *v.* Am. Sur. Co., 49 Pittsburg L. J. 312; Am. Bond. & Tr. Co. of Baltimore City *v.* Progressive Permanent Bldg. Loan & Sav. Ass., 101 Md. 323; 61 Atl. 199; Brown *v.* First Nat. Bank of Newton, 132 Fed. 450; Am. Bond. Co. *v.* P. I. Co., 150 Fed. 17.

[2] 117 Ia. 10; 90 N. W. 590.

to preserve some lien or security which he has for the principal's debt. It is on the third ground that the surety seeks release in this case. But in this respect the duty of the creditor towards the surety seems to be analogous to that of a trustee holding the same right to which the surety would become entitled by way of subrogation, if he should discharge the debt. The creditor is not bound to any active diligence in enforcing his claim against the principal, for it is the debt of the surety also, but he must not do any act injurious to the surety or inconsistent with the surety's rights.

"The discharge of the surety (by some act of the creditor) is based on some recognized and well-defined principle, and in general results from a positive act of the creditor which operates to the prejudice of the surety. Passiveness on the part of the creditor will not discharge the surety unless he omits to do, when required by the surety, what the law or his duty enjoins him to do, or unless he neglects, to the injury of the surety, to discharge his duty in any matter in which he occupies the position of trustee for the surety.

"As is said in Thornton *v.* Thornton,[1] the creditor is not bound for the benefit of the surety to protect his 'potentialities.' In the application of the doctrine that the creditor is not charged with any active duty in behalf of the surety to enforce payment of the claim out of the property of the principal, it has been held that the creditor is not bound to file his claim in case of the principal's insolvency, nor to present it as a claim against the principal's estate after his death. If the creditor has acquired a lien, as by the levy of an execution or an attachment on the principal's property, then he can release it or abandon it without releasing the surety *pro tanto.* But the creditor is not bound to prosecute his claim to judgment against the principal before looking to the surety, nor even after taking judgment against the principal is he bound to follow it by attempting to reach the property of the principal. And even where a creditor has a lien he is not bound to enforce it for the surety's protection. All that is required of him is that he do not release or abandon it."[2]

[1] 63 N. C. 211.

[2] See also to the same effect, Am. Sur. Co. *v.* Law. Cem. Co., 96 Fed. 25; 110 Fed. 717; U. S. *v.* Am. Sur. Co., 110 Fed. 913; Hipwell *v.* Nat. Sur. Co., 130 Ia. 656; 105 N. W. 318; Brown *v.* First Nat. Bank of Newton, 132 Fed. 450; Ætna Indemn. Co. *v.* Auto Traction Co., 147 Fed. 95; Am. Bond. Co. *v.* Pub. Inv. Co., 150 Fed. 17; City of N. Y. *v.* Baird, 77 N. Y. Sup. 446; 74 App. Div. 238; 176 N. Y. 269; Am. Bond. Co. *v.* Progressive Permanent Bldg. Loan & Sav. Ass., 101 Md. 323; 61 Atl. 590; Am. Sur. Co. *v.* S. A. L. & Tr. Co., Tex. ; 98 S. W. 387.

A closely related question to the one now before us was under discussion by the Iowa Supreme Court in Whitehouse *v.* American Surety Company.[1] It appears that the Iowa Code[2] provides that every laborer who as subcontractor shall perform labor on any public building not belonging to a city, shall have a claim against the public corporation constructing such building for the value of his services not in excess of the contract price, but that the corporation shall not be required to pay any such claim before or in any different manner from that provided in the principal contract; that the claim shall be made by filing with the public officer through whom the payment is to be made a statement of the amount; that such claims shall have priority in the way in which they are filed. In the case referred to a contractor with a city gave a bond with surety for the payment of labor claims; and the labor claimants filed with the city auditor their claims for a preference out of the funds due the contractor, but they were denied because of defective procedure. No appeal was taken, and the funds were exhausted in the payment of other claims. The surety on the bond, when sued on the other claims, contended that it was not liable because claimants had not preserved their claims against a fund out of which it might have been preserved from loss. It was held that the surety was not released, for under the statute the claimants had no lien, but only a preference, and they were not bound to prosecute an action to obtain a lien. The court in its opinion spoke as follows:

"A creditor should apply for payment of his debt, or hold in trust for the benefit of the surety, all securities which he may receive or procure for that purpose by contract or by operation of law, so that, if compelled to discharge the debt, the surety may be subrogated to them. But the law, in the absence of special statute, annexes no condition requiring the creditor to proceed against the principal debtor or to do any act, no matter what his opportunity, to procure security or enforce payment from that principal. He may remain entirely passive and rely on the undertaking of the surety. So if he commences

[1] 117 Ia. 328; 90 N. W. 727.

[2] § 3102.

a suit he is under no obligation to pursue it, unless he has made an actual levy on the goods of the principal or others, and thus obtained a lien."

§ 219. **Discharge of Liability by Payment of Loss.** — The insurer cannot be called to meet his obligations until the fact that the "risk" has failed to meet his engagement becomes apparent to the court.[1] With respect to the insured the insurer is to be regarded as the principal, even when it signs the indemnity agreement in terms as a surety.[2]

Where separate suits are pending on one policy, it would seem just that the insurer be permitted to maintain a suit in equity through which the funds in its hands can be equitably distributed.[3]

Where claims of material-men are in excess of the insurer's liability named in the policy running to the United States, the equitable rule of *pro rata* distribution will be applied and no priority should be given to the United States or to any individual creditor by reason of his having first commenced suit. In such a case the United States is to be regarded as having voluntarily made itself trustee alike for its own interests and for the interests of the material and labor men, and having thus voluntarily created and accepted a trust, it is barred by equitable principles from asserting for itself any advantage over other beneficiaries.[4]

In an English case a policy was issued guaranteeing to the holder of a deposit receipt, payment of his deposit if the debtor made default for more than twenty-one days after May 15, 1893. The facts in this case were as follows: On April 4 the bank suspended payment; on April 22 the insurer accepted notice of a claim; on April 26 a scheme for the reconstruction of the bank was provisionally approved; on May 15,

[1] Union Tr. Co. *v.* Cit. Tr. Co., 185 Pa. St. 217; 39 Atl. 886.

[2] U. S. to the Use, etc. *v.* Hazzard, *et al.*, 53 N. Y. App. Div. 410; 65 N. Y. Sup. 1051.

[3] See Von Dendriesch *v.* Rohrig, 45 N. Y. App. Div. 526; 61 N. Y. Sup. 341.

[4] Am. Sur. Co. *v.* Law. Cem. Co., 96 Fed. 25; 110 Fed. 717; see also U. S. *v.* Am. Sur. Co., 110 Fed. 913.

the deposit became due and was not paid; June 11 the reconstruction scheme was finally approved, and in virtue thereof became binding upon the bank and its creditors as from April 26, with the result that the bank was freed from all its obligations and its liabilities passed in a modified form to the new bank. It was held that the policy was to be regarded as a contract of indemnity, and that the insured was entitled to recover from the insurer what the bank failed to pay when it became due, and that an assignment by the insured of such rights as he had against the bank would satisfy the policy.[1]

Where the insurer guaranteed payment to a depositor of the deposit receipt of a bank, "after default" in payment by the bank, and the bank stopped payment and had failed to pay when the receipt became due, it was held that the bank was in default, notwithstanding it was reconstructed.[2]

§ 220. **The Measure of Damages.** — The case of American Surety Company *v.* Woods[3] is to be regarded as a leading case on the subject of the measure of damages under policies of contract insurance in this country. The facts therein — so far as they are material to the question of damages — were as follows: The "risk" (a firm of contractors), being about to construct certain sewers in the city of New Orleans, furnished in connection therewith a bond issued by the American Surety Company to the New Orleans Sewerage Company, providing that the "risk" should well and truly, and in good, sufficient and workmanlike manner, perform the work provided for in the separate contract of the "risk" with the insured, bearing even date with the bond, in accordance with the terms and conditions therein stipulated, and in each and every respect

[1] Laird *v.* Secur. Ins. Co., 22 Rettie, Scotch Sess. Cas. 452.

[2] Young *v.* Trustee Assets & Inv. Ins. Co., 21 Rettie, Scotch Sess. Cas. 222; see generally Buck *v.* Guarantors Lia. Indemn. Co., 34 S. E. 950; 97 Va. 719; see also Am. Sur. Co. of N. Y. *v.* Venner, 183 Mass. 329; 67 N. E. 331; Leppert *v.* Flaggs, 101 Md. 71; 60 Atl. 450.

[3] 105 Fed. 741; 106 Fed. 263; 45 C. C. A. 282.

comply with the conditions and covenants therein contained. The "risk" thereupon commenced work under its said contract and continued to do so for several months, when it refused to proceed further with the work on the ground that a fraud had been practised upon it in obtaining it, and that even if such contract had been valid in its inception, it had been released therefrom by a violation of its terms on the part of the insured. The latter thereafter went into the hands of a receiver and made no attempt to complete the contract so repudiated by the "risk." It was in fact never completed. Later on the receiver brought suit on the bond, alleging that damages had been sustained by reason of the non-performance of the contract on the part of the "risk," beyond the amount of such bond. The specific ground of such alleged damage was said to be, that had "risk" performed its contract properly, the cost of the work to the insured would have been $739,500, while the cost of the work already done by the "risk," together with the amount which it would have cost and will cost to complete said work, was $912,099.09, and that by reason thereof the insured was damaged in the sum of $172,599.09. At the trial the court instructed the jury with reference to damages as follows:

"(I) If the 'risk' abandons the work before completion and refuses to complete the same, having no lawful cause for such action, the measure of damages which the insured is entitled to recover is the difference between the cost of completing the work at the contract price and what it would have cost him to complete the work or to procure the work completed by others. (II) After the abandonment of the contract by the 'risk,' the insured would have had the right to have gone on and completed the work itself, or to have let out a contract for the completion of the work to other contractors upon the best terms attainable, and in that case they would have had the right to recover as damages the difference between what it would have cost if the 'risk' had complied with the contract and what it actually cost the insured to complete the work. But the insured was not bound to complete the work or to employ anybody else to complete the work, and in lieu thereof, in order to prove damages, they had the right to offer testimony as to what it would have cost them to complete the

work or have it completed, and upon such testimony to recover from the insurer the difference between the necessary cost of completion as thus established, and what it would have cost under the contract of the insured with the 'risk.'"

Under these instructions the jury found a verdict of $90,000 against the American Surety Company, who at once sued out a writ of error to the United States circuit court of appeals (fifth circuit). In holding that the foregoing instructions were erroneous, the appellate court spoke as follows:

"Under the common law there must be, to authorize a recovery, a breach of the contract which causes damage. If only a breach is shown, there could only be a verdict for a nominal sum. When a contract is discharged unlawfully, he can, in a suit for damages, recover his outlay and the probable certain profits he would have made if he had been permitted to proceed with the work. His profits in such case would have been a gain he would have received but for the unlawful act of his employer. . . .

"By the terms of the contract sued on, the contractors were to furnish all necessary labor to excavate and build the sewers. The sewerage company was to furnish at its own cost all materials of every kind required to construct the sewer. We must bear in mind, therefore, that the contract on the part of the contractors was one to labor or to furnish labor. . . .

"It is contended that as a contractor, in the case of a breach of the contract by the employer, can recover his lost profits, and that he would be permitted to prove what it would cost to complete the work he was prevented from doing, and where it cost him less than the contract price could recover the difference as the profit which he would have made, that in all fairness the same rule should apply when a breach of the contract is made by the contractors. There are several considerations making differences in the two cases. When the contractor is stopped from work by the owner or employer who is to furnish the materials, he cannot go on and finish the work. He cannot, by completing the work himself, or by others, show just what his profit, if any, would be. When he sues for damages, therefore, he must, to recover profits, prove, if he can, what he would have made had he not been stopped. He is prevented from finishing the work, and such evidence is necessary to show what gain or profit to him was in the contract. On the other hand, when the contractor abandons

the work, the owner or employer is kept in possession. He is free to employ others to finish the work. He has it in his power by employing others to complete the work to ascertain exactly the amount of his damages. The contractor, when stopped, or unlawfully discharged by the breach of the contract by the employer, has not this power. For the breach of a contract the injured party is entitled in a suit for damages to receive compensation for his loss, and nothing more. . . . The contractor or builder stopped from his work by the breach of the contract committed by his employer has clearly lost the profit that he would have certainly made by the completion of the work. His loss would have been certain in the event he had the work done at a cost greater than the contract price. The contention that the measure of his damages is the difference between the contract price and a greater price which he has never paid must be based on the erroneous theory that the contract is necessarily worth to him the sum above the contract price it would cost the contractor to finish the work. The fact that the contractor would lose a fixed sum by completing the work does not show that the contractor would lose that sum by the failure of the contractor to finish it. If the contractor stops the work and the employer does not complete it, it cannot be said that he has been damaged what the former would have lost had he not stopped the work. When the contractor breaks his contract he is liable to his employer for the amount the employer is damaged, but it does not follow that he is liable for the amount the contractor saved by the abandonment of the contract. It is a mistake to assume that whatever the contractor saved by stopping the work was lost by the employer who does not complete it. . . .

"In the absence of legal defence, the employer can, of course, recover damages for a breach of the contract of employment by the employee. Where the employee or contractor, without legal cause, abandons the work unfinished, the right of the employer to sue for a breach of the contract is not dependent upon his completing the abandoned work. He may sue at once and recover of the employee or contractor such damages as under legal rules he can show he has sustained. But when the employer does not name the expense of completing the work and determines not to finish it, the sum which the contractor would have lost had he complied with the agreement and finished the work, or the difference between the contract price and the cost of completing the work, cannot be taken as the measure of damages."

Again in this same case where the "risk's" contract with the insured provided that in case of delay in doing the

work, the latter might take charge thereof and complete it at the cost of the "risk," it was held that this not only provided the measure of the insurer's liability under the policy in case of breach of the "risk's" obligations to the insured, but also the manner in which such liability should be arrived at.

"Such a provision of the contract," observed the court, "conceding a different rule to prevail in its absence, rescues the case from the uncertain and speculative control of expert witnesses and applies to it the practical test of actual cost. It secured to both the 'risk' and the insurer a valuable right of which they should not be deprived."

In a Pennsylvania case the measure of damages to the insured as grantee of certain ground rents, under a policy insuring the completion of certain buildings agreed to be erected therein within a designated period after the sale of such ground rents, for the non-completion of such buildings, was said to be the difference in the market value of the ground rents if the buildings had been completed according to agreement and their value with the buildings in the uncompleted state in which they were left, not to exceed the amount of the insurance.[1] Again in American Surety Company *v.* Lucas[2] the question of the measure of damages under a policy of contract insurance was discussed at some length.

In this case the insured sought to recover damages from the insurer on account of sums expended by him in completing a contract of the "risk" (a subcontractor) amounting to $14,908. At the time the work was abandoned by the "risk," there was due from the county on account of the work (a court-house) $22,500. Against this balance there was an order from the insured calling for the payment to the "risk" of $5000, or so much as might be advanced by the bank (as holders of this fund for the county) out of the next estimate

[1] Ger. Am. Tit. & Tr. Co. *v.* Cit. Tr. & Sur. Co., 190 Pa. 247; 42 Atl. 682; see generally on this subject, Union Tr. Co. *v.* Cit. Tr. & Sur. Co., 185 Pa. St. 217; 39 Atl. 836; Am. Bond. & Tr. Co. *v.* U. S., 15 App. D. C. 397.

[2] 57 S. W. 969.

of the amount due on the work. The next estimate referred to was $10,000. The bank advanced money to the "risk" upon this order, and when the "risk" failed, he was indebted to the bank $13,050. Upon settlement by the county, this order was paid by the insured as for $10,000, and charged against the $22,500 balance. The insured compromised with the county on account of claims for delay in completing work by agreeing to pay the bank's deficit, $3050, and also additional claims against the county for $1248.47 for lumber bills. Then the county paid the insured $12,500 less the amount of such lumber bills, the insured first paying the bank $3050. It was held that the insured, as against the insurer, was entitled to charge against the $22,500 balance only $5000 on the order, and must account for any excess of that amount paid on such order in settlement with the insurer; but he was allowed a credit for damages for the delay due the county for not completing the building in time.

We now call attention to certain cases bearing on the question as to how far the courts will go in sustaining, in actions on contract insurance bonds, provisions in the contract covered thereby, to the effect that in case of default therein on the part of the "risk," the insured may recover a certain named sum by way of liquidated damages for a breach thereof.

"It is well understood," observed the Wisconsin Supreme Court in a recent case,[1]

"that the words 'penal sum' in that part of the contract and bond providing for the consequences of a breach thereof, are ordinarily to be construed strictly and as meaning a penalty and nothing more, and that, in such case, actual damage must be shown. It is also understood that this ordinary import may be overcome by other parts of the contract which demonstrate that the words were used as meaning liquidated damages. So, also, if the same be termed 'liquidated damages,' this fact will not be conclusive upon the courts; but if the sum fixed be largely in excess of actual damages, or it appear that the same was fixed to avoid usury laws or to cloak oppression, the courts will construe it as a penalty. It is also said that where the sum fixed is

[1] City of Madison *v.* A. S. E. Co., 118 Wis. 480; 95 N. W. 1097.

excessive and the damages are wholly uncertain and incapable of ascertainment by any known rule, the courts will not consider the sum named as liquidated damages.

"Tested by these general principles, we are convinced that the sum named in the bond in the present case must be regarded as a penalty. In the first place, it is named as a 'penal sum,' which is the appropriate language for the designation of a penalty, and this fact has considerable significance when the agreement or bond is drawn and scrutinized by lawyers before acceptance, as in the present case. In the second place, the bond is given to insure the performance of 'all the covenants, conditions, warranties and agreements' contained in the principal contract, which are quite numerous and some of which are trivial in their nature. It is very manifest that in the absence of language to that effect, the penal sum named cannot be construed as liquidated damages for the breach of one covenant or agreement and a penalty only for the breach of others."

Where the "risk" agrees to complete a building for the insured on a certain date, and in default thereof to pay him ten dollars for every day thereafter that the building remained unfinished, as liquidated damages and thereafter defaults, the amount per day agreed to be paid is to be regarded as a penalty, and the insured will be limited in his recovery against the insurer to the actual damage he has sustained.[1]

A building contractor having failed to complete the buildings within the time specified, the owner was entitled to recover from the contractor's surety company loss of rents which he would have received if the buildings had been completed in time.[2]

The same question was before the Supreme Court of Minnesota in City of Winona *v.* Jackson.[3] In its opinion thereon the court spoke as follows:

"Plaintiff also appealed from the judgment, and this appeal presents the bare question whether the city is entitled to recover certain liquidated damages provided for in the contract between it and Jackson and Bekonry. The contract required defendants to complete the sewer

[1] Weedon *v.* Am. Bond. & Tr. Co., 38 S. E. 255; 128 N. C. 69; see also Boyce *v.* U. S. Fid. & Guar. Co., 111 Fed. 138.

[2] Donlan *v.* Am. Bond. & Tr. Co., 139 N. C. 212; 51 S. E. 924.

[3] 92 Minn. 453; 100 N. W. 368.

on or before the date specified therein, and provided on the failure to do so that they should pay the city as liquidated damages $25 per day, for each and every day the work remained uncompleted after the date named. The contention of plaintiff is that this liability of the contractors was included within the terms and conditions of the bond, and that it is entitled to recover the amount thereof against the surety. We do not concur in this contention. It is elementary that a surety is a favorite of the law and has the right to insist upon the strict letter of his contract; a claim against him is *strictissimi juris.* The bond on which this action was brought contains no condition which may fairly be said to obligate the surety to pay the liquidated damages mentioned. Its conditions, so far as here material, are to the effect that the contractors shall pay as they become due all just claims for work and labor performed, and for all material furnished in the execution of the contract, and that they will indemnify the city against any damage or loss which may arise directly or indirectly from the performance of the work by reason of their negligence or misconduct, or the negligence of their servants or employees, and, further, that they will complete the contract according to its terms, and save the city from any cost, charge or expense that may accrue or arise from the doing of the work specified in the contract. There is no provision or condition which obligates the 'risk' or the surety company to pay to the city the liquidated damages referred to, and no liability so far as the surety is concerned, exists by implication of law."

On the other hand, they are courts which have arrived at conclusions differing materially from the foregoing.

Thus, where a contractor agreed to complete certain work by a certain date or pay a certain sum as liquidated damages, and the surety on his bond agrees to protect the insured from all loss arising from the non-fulfilment of the covenants of the contractor and through his delay in completing the work, it was held that the surety company, as well as the "risk," is bound to pay the amount fixed as liquidated damages without any proof of actual loss.[1] On this same subject a federal court has spoken as follows:

"This section being imported into the bond, it results that under this law enacted by Congress the bond is to be read as if it in so many

[1] Merc. Tr. Co. *v.* Hensey, 27 D. C. App. 210.

words provided that upon the default the bidder and his sureties should be liable for the amount of the bond as liquidated damages. The meaning of the words 'liquidated damages' is of well-understood and recognized significance. These words are used in reference to the breach of a contract or the non-performance of a duty as imposing a fixed sum, which is agreed upon between the parties as the ascertained damage which the one is to receive and the other to pay because of the default. It is quite true that when the obligation is expressed in the customary form of a bond the amount recoverable is the damage actually sustained. But as the words 'liquidated damages' have a well-known meaning and are used to distinguish a specific sum agreed upon by the parties to be paid in case of default over a penal sum, construed as intended only to secure the actual damage, it cannot be justly said that the words 'liquidated damages' were used by Congress without intending what the words imparted." [1]

A proposal bond given by a bidder for a contract for carrying the mail conditioned as required by act June 23, 1874,[2] which provides that "every proposal for carrying the mail shall be accompanied by the bond of the bidder, and in case of the failure of the bidder to enter into such a contract to perform the service, or, having executed a contract, in case of failure to perform the service according to his contract, he and his sureties shall be liable for the amount of such bond as liquidated damages, to be recovered in an action of debt under such bond," is an absolute undertaking to pay the amount named therein as liquidated damages in case of condition broken and not one of indemnity or security to the government against loss or damages for breach of contract, and in an action thereon the actual damages cannot be inquired into.[3]

A contract for the installation of a heating apparatus in a municipal building gave the municipality power to terminate the employment and take charge of the work on the contractor failing to supply a sufficient number of workmen, the proper

[1] U. S. *v.* U. S. Fid. & Guar. Co., 151 Fed. 534.

[2] c. 456, § 12, 18 Stat. 235; U. S. Comp. St. 1901, p. 2695.

[3] U. S. *v.* Alcorn, *et al.*, 145 Fed. 995; 151 Fed. 534.

materials, etc., and stipulated for liquidated damages on the contractor failing to perform the work within a specified time. The municipality, on the contractor failing to comply with the performance of the contract, terminated it and took possession of the work and completed it. It was held that the municipality was not entitled to the liquidated damages stipulated for.[1] In another case an iron company agreed to supply a construction company with steel for a bridge. The price of the steel was fixed at a certain rate per pound, the aggregate amount not being stated, and was not ascertainable directly from the contract. A surety company guaranteed the "payment for such material not to exceed in the aggregate $13,000." It was held that the latter was only liable to pay for material to the value of not to exceed $13,000.[2]

Where a contractor fails to perform work in accordance with the plans and specifications of a building contract, the measure of damages in a suit on his bond is the difference between what the work is worth when completed and what it would have been worth had it been performed as required by the contract. And neither the contractor nor his surety can escape liability by getting possession of a mortgage on the property and selling the property at foreclosure sale.[3]

If the insurer stands ready and willing at all times to settle its liability after default of the "risk," but has been obliged to invoke the aid of a court of equity to marshal and adjust the claims of the various parties insured which exceed in the aggregate the total amount of the policy, it cannot be charged with interest on the amount thereof, because of the delay incident to such proceedings.[4]

General creditors of the "risk," not protected by the policy, have no right to demand that they be subrogated in equity to a security taken by an insurer to indemnify it

[1] City of New Haven *v.* Nat. Steam Economizer Co., *et al.*, Conn. ; 65 Atl. 959.

[2] Am. Br. Co. *v.* Col. Tr. Co., 215 Pa. 305; Atl. .

[3] Merc. Tr. Co. *v.* Hensey, 27 D. C. App. 210.

[4] Am. Sur. Co. *v.* Lawrenceville Cem. Co., 110 Fed. 717.

against loss by reason of the issuance by it of a policy of contract insurance.[1]

An insurer taking a counter indemnity bond from the "risk" is not prejudiced by any undisclosed relation existing between the signers thereof not disclosed on the face of the policy nor by the indemnifying agreement. It is entitled to stand, with reference to the right of reimbursement from the indemnitor, on the position most favorable to itself, and the fact that the insurer has been reimbursed for a payment of one claim through such indemnitor does not enlarge its liability to other creditors of the "risk" as to whom, in the marshalling of claims, the claim paid must be treated as though the insurer had not been reimbursed.[2]

In marshalling claims against a "risk" as against the insurer issuing a policy conditioned upon the payment of the same, the fact that certain of the claims have been purchased by one who has bound himself to indemnify the insurer does not increase the amount to which other claimants are entitled, and for the purpose of making distribution to them, such claims must be treated as still subsisting.[3]

In a suit on an official bond conditioned that the party making it should comply with and faithfully execute a certain contract for which the bond was given to secure the performance of, any breach thereof would entitle the plaintiff to recover at least nominal damages, and a construction ignoring that principle would be erroneous.[4]

[1] Am. Sur. Co. *v.* Lawrenceville Cem. Co., 110 Fed. 717.

[2] *Idem.*

[3] *Idem.;* see also U. S. *v.* Am. Sur. Co., 110 Fed. 913.

[4] Fid. & Dep. Co. of Md. *v.* Calvin & Jackson, 83 Mo. App. Rep. 204. As to method of computing damages under contract insurance bonds, see Nat. Sur. Co. *v.* T. B. T. Br. & Con. Co., 178 Ill. 156; 52 N. E. 938; U. S. to the Use of Snyder, *et al. v.* Hazzard, *et al.*, 53 App. Div. N. Y. 410; 65 N. Y. Sup. 1051; U. S. *v.* McIntyre & Fid. & Dep. Co., 111 Fed. 590; Chicago House Wrecking Co., *et al. v.* U. S., 106 Fed. 385; Am. Sur. Co. *v.* Woods, 105 Fed. Rep. 741; 106 Fed. 233; 45 C. C. A. 282; Boyce *v.* U. S. Fid. & Guar. Co., 111 Fed. 138; Am. Bond. & Tr. Co. *v.* Takahashi, *et al.*, 111 Fed. 125; Nat. Sur. Co. *v.* Sewerage & Water Board of New Orleans, 141 Fed. 325; Fid. & Dep. Co. *v.* Calvin & Jackson, 88 Mo. App. 204; U. S. *v.* U. S. Fid. & Guar.

CHAPTER XVII

CREDIT INSURANCE

§ 221. **Definition and Nature of Credit Insurance.** — Credit insurance is a subsidiary form of commercial insurance, and may be defined as an agreement whereby, for a valuable consideration, the insurer agrees to indemnify the insured in a specified amount against losses arising through the insolvency of third parties to whom goods and merchandise have been sold on a credit basis by the insured. Credit insurance, as thus defined, constitutes a valid form of insurance.[1] The

Co., 144 Fed. 866; U. S. *v.* Alcorn, *et al.*, 145 Fed. 995; Nat. Sur. Co. *v.* Sewerage & Water Bd. of New Orleans, 141 Fed. 325; U. S. *v.* Am. Sur. Co. of N. Y., 135 Fed. 78; Westcott *v.* Fid. & Dep. Co. of Md., 84 N. Y. Sup. 731; 87 App. Div. 497; Buffalo Premium Ins. Co. *v.* Tit. & Guar. Tr. Co., 99 N. Y. Sup. 883; 51 Misc. 267; Am. Br. Co. *v.* Col. Tr. Co., 215 Pa. 305; Atl. ; Phila. *v.* Malone & Co., *et al.*, 214 Pa. 90; City of Madison *v.* A. S. E. Co., 118 Wis. 480; 95 N. W. 1097; City of Winona *v.* Jackson, 92 Minn. 453; 100 N. W. 368; Hipwell *v.* Nat. Sur. Co., *et al.*, 130 Ia. 656; 105 N. W. 318; Bagwell *v.* Am. Sur. Co. of N. Y., 102 Mo. App. 707; 77 S. W. 327; Sexton, *et al.* *v.* McInnis, Ore. ; 86 Pac. 778; Equitable Tr. Co. *v.* Bowen, 201 Pa. 534; 57 Atl. 371; Murphy *v.* U. S. Fid. & Guar. Co., 91 N. Y. Sup. 580; U. S. *v.* U. S. Fid. & Guar. Co., Md. ; 151 Fed. 534; Leppert *v.* Flaggs & U. S. Fid. & Guar. Co., 101 Md. 71; 60 Atl. 450; Bubb *v.* Am. Bond. & Tr. Co., 47 Pittsburg L. J. 361; City of New Haven *v.* Nat. Steam Economizer Co., *et al.*, 79 Conn. 482; 65 Atl. 959; Crowley *v.* U. S. Fid. & Guar. Co., 29 Wash. 268; 69 Pac. 784; Donlan *v.* Am. Bond. & Tr. Co., 139 N. C. 212; 51 S. E. 924; Merc. Tr. Co. *v.* Hensey, 27 D. C. App. 210; St. P. Tit. & Tr. Co. *v.* Sabin & the U. S. Fid. & Guar. Co., Wis. ; 87 N. W. 1109; U. S. etc. *v.* McIntyre & Fid. & Dep. Co., 111 Fed. 590; U. S. etc. *v.* Morgan & Am. Sur. Co., 111 Fed. 444; Mulin & Fid. & Dep. Co. *v.* U. S., 109 Fed. 817; Boyce *v.* U. S. Fid. & Dep. Co., 111 Fed. 138; Am. Bond. & Tr. Co. *v.* Takahashi, 111 Fed. 125; Parrs Bank *v.* Albert Mines Syndicate, 5 Commercial Cases, 116; Am. Bond. & Tr. Co. *v.* U. S., 15 D. C. App. 397; Exposition Amusement Co. *v.* Em. St. Sur. Co., Wash. ; 96 Pac. 158; Nat. Sur. Co. *v.* Foster Lumber Co., Ind. ; 85 N. E. 489.

[1] Lauer, *et al.* *v.* Gray, 55 N. J. Eq. 544; 37 Atl. Rep. 53; People *v.* Merc. Cr. Guar. Co., 166 N. Y. 416; 60 N. E. 24; Tebbetts *v.* Merc. Cr. Guar. Co., 73 Fed. 95; 19 C. C. A. 281; Strouse *v.* Am. Cr. Ins. Co., 91 Md. 244; 46 Atl. 328.

Supreme Court of Wisconsin, in construing a policy of credit insurance, remarked, with reference to the same:

"We regard the contract before us as unquestionably a contract of insurance. An insurance contract is an agreement whereby one party agrees to wholly or partially indemnify another for loss or damage which he may suffer from a specified peril. The peril of loss by the insolvency of customers is just as definite and real a peril to a merchant or manufacturer as the peril of loss by accident, fire, lightning or tornado, and is, in fact, much more frequent. No reason is perceived why a contract of indemnification against the ever present peril of insolvency is not just as legitimately a contract of insurance as a contract which indemnifies against the more familiar but less frequent peril of loss by fire."[1]

Again, in passing on a credit insurance policy, the New Jersey court of appeals said:

"The business for which this corporation was created was the issuing of certificates of guaranty, which may be called contracts of insurance or indemnity to traders for losses incurred by the failure of their customers who are debtors to the traders and become insolvent. . . . Indeed, so peculiar is the system of insurance engaged in by this company that its contracts of insurance appear to be protected as its exclusive property by a copyright."[2]

In the case of State *v.* Phelan,[3] the court held that a contract of credit insurance violated no rule of public policy, and that the contingency provided against in a credit insurance policy was a proper matter of insurance. "The indemnity contract," observed the court,

[1] Shakman *v.* The U. S. Cr. Sys. Co., 92 Wis. 366; 66 N. W. 528.

[2] Gray *v.* Reynolds, 55 N. J. Eq. 501; 37 Atl. 461; on question of validity of credit insurance, see Clafflin *v.* U. S. Cr. Sys. Co., 165 Mass. 501; 43 N. E. 293; see also on general subject of credit insurance, Smith *v.* Nat. Cr. Ins. Co., 65 Minn. 283; 68 N. W. 28; Hayne *v.* Metropolitan Tr. Co., 67 Minn. 245; 69 N. W. 916; Robertson *v.* U. S. Cr. Sys. Co., 57 N. J. L. 12; 29 Atl. 421; Strouse *v.* Am. Cr. Ins. Co., 91 Md. 244; 46 Atl. 328; People *v.* Met. Cr. Co., 166 N. Y. 416; 60 N. E. 24; Im. Mfg. Co. *v.* Am. Cr. Ins. Co., 26 Ins. L. J. 926; McCallum, *et al.* *v.* Nat. Cr. Ins. Co., *et al.*, 86 N. W. 892; Am. Cr. Ins. Co. *v.* Ellis, 156 Ind. 212; 59 N. E. 679.

[3] 66 Mo. App. 548.

"is essentially the same as that secured by insurance. That it may have some of the features of suretyship or guarantee does not detract from its character as a contract of insurance."

§ 222. **Scope of Credit Insurance.** — The New York court of appeals, in a late case, gave the following exposition of the general purpose and scope of credit insurance: "It would seem to be necessary to inquire with respect to the scope, purpose and meaning of the policy under which the claim is made. . . . The purpose was to indemnify the claimants from loss by insolvency of such debtors as had made a general assignment for the benefit of creditors. The claimants have sustained the loss since an assignment has been made. The assignment or transfer in each case was for the benefit of creditors or a creditor, and it is general in the sense that it embraced, substantially, all the property that the debtor had. The assignee in each case went into possession, and the assignor ceased to do business. The debtor, owing the claimant, thereby lost the title, possession and dominion over all he had, and thereby became disabled to pay any one else. It would seem to be reasonable in such a case to conclude that the claimant had sustained a loss by reason of the insolvency of a debtor who had made a general assignment within the fair meaning of the policy.

"The contract in question was prepared by the insurer and intended for use, not in any particular state or locality, but throughout the country generally. The local law in any state, with respect to its construction, is not to govern. Each state may have laws and statutes of its own that govern general assignments for the benefit of creditors, but these terms are not used in the policy in question in any statutory or local sense. When the insurer indemnified against insolvency of debtors who had made a general assignment for the benefit of creditors, the contract is not to be interpreted technically, but the language must be held to mean what the words import in the commercial world. Hence the character of the instrument or the nature of the transaction must be determined by the effect it has upon the debtor in the business community, and not by the name which the parties see fit to give it. It may be a statutory assignment, a mortgage, a confession of judgment or some other contrivance, the purpose and effect of which

are to dispose of all the debtor's assets and disable him from paying his debts. In such cases the loss is fairly within the scope of the indemnity secured to the insured by the policy. It is the completeness of the transfer and its effect upon the debtors in business, and not the name or form of the instrument or transaction, that give it character. Any transfer by a trader or merchant of all his stock and business, when it covers substantially all his property, may be an assignment within the meaning of the policy, in spite of the form or the name given it."[1]

§ 223. **Construction of Policies.** — "Insurance against mercantile losses," observed Judge Lacombe, of the United States circuit court of appeals for the second circuit,[2] "is a new branch of the business of underwriting, and but few cases dealing with policies of that character have as yet found their way into the courts. The necessarily nice adjustment of the respective proportions of loss to be borne by insurer and insured, the somewhat intricate provisions which are required in order to make such business successful, and the lack of experience in formulating the stipulations to be entered into by both the parties to such a contract, have naturally tended to make them crude and difficult of interpretation." Then, after quoting with approval certain cases holding that all ambiguous clauses of policies of insurance are to be construed in favor of the insured, Judge Lacombe continued as follows:

"In the light of well-settled principles of law expressed in these authorities, the contract under consideration must be construed. The cases cited, holding that the surety is a favorite of the law and that a claim against him is *strictissimi juris*, have no application. Corporations entering into contracts like the one at bar may call themselves 'guarantee' or 'surety' companies, but their business is in all essential particulars that of insurers, who, upon careful calculation of the risks of such business and with such restrictions of their liability as may seem to them sufficient to make it safe, undertake to assure persons against loss, in return for premiums sufficiently high to make such business commercially profitable. These contracts are, in fact, policies of insurance and should be treated as such."[3]

[1] People *v.* Merc. Guar. Co., 166 N. Y. 416; 60 N. E. 24.

[2] Tebbetts, *et al.* *v.* Merc. Cr. Guar. Co. of N. Y., 73 Fed. 95; 19 C. C. A. 281.

[3] See also Goodman *v.* Merc.

Contracts of this character must be given a reasonable construction so as to give effect to the intention of the parties and so as to carry out, rather than defeat, the purpose for which they have been executed. They should neither, on the one hand, be so narrowly or technically interpreted as to frustrate their obvious design, nor, on the other hand, so loosely and inartificially as to relieve the insurer from liability fairly within the scope or spirit of their terms.[1]

In case of ambiguity or uncertainty concerning the meaning of conditions in contracts of this character, that meaning is to be adopted which is most favorable to the assured. That rule is justly applicable to the words used in the policy in question, where there is nothing to show that they were used in any narrow, special or local sense.[2]

All conditions limiting liability are to be strictly construed. In the interpretation of conditions they are to be construed liberally in favor of the insured, and strictly against the insurer. The policy should be interpreted in such a way as to accomplish the general purpose had in view and at the same time give effect to all of its conditions according to their fair and reasonable meaning.[3]

§ 224. **Applications for Policies.** — As in other branches of guaranty insurance law, the issuance of a policy is preceded by a formal " proposal " for the same filled out by the prospective insured on blanks furnished for that purpose by the credit insurance company. Such applications, when so filled out and signed by the insured, are by their terms made part of the policy to be thereafter issued, and the answers therein contained are a part of the consideration which is recited in such policy as the inducement for the issuance of the same by the

Cr. Guar. Co. of N. Y., 45 N. Y. Sup. 508; 17 N. Y. App. Div. 474; Am. Cr. Ins. Co. *v.* Wood, *et al.*, 73 Fed. 81; 19 C. C. A. 264; Merc. Cr. Guar. Co. *v.* Littleford Bros., 18 O. Cir. Ct. Rep. 889.

[1] Am. Cr. Ins. Co. *v.* Cassard, 83 Md. 272; 34 Atl. 703; see also Rosenbaum *v.* U. S. Cr. Sys. Co., 60 N. J. L., 294; 37 Atl. 505; 44 Atl. 966.

[2] People *v.* Merc. Cr. Guar. Co., 166 N. Y. 416; 60 N. E. 24.

[3] *Idem;* see also Merc. Cr. Guar. Co. *v.* Littleford Bros., 18 O. Cir. Ct. Rep. 889.

insurer.[1] The general purpose of the insurance companies in requiring such applications is to ascertain the nature and extent of the liability to be named, so that it may determine whether or not to issue the policy, and if so under what conditions and at what premium.

§ 225. **The Policy: its Form and Content.** — The form of the policy issued by the various credit insurance companies is not always uniform, and for that reason it is difficult to state in detail the usual content of such policies. Speaking generally, it may be said that credit policies are ordinarily issued in the form of a bond of indemnity, to which are attached, either in the form of "riders" or by insertion thereof in the body of the policy, certain conditions which serve to define and limit the liability of the insurer and at the same time control the conduct of the insured during the period of liability by prescribing a line of action for him to pursue with reference to such insurer. The content of such policies usually embraces the following matters: parties, amount, period and scope of liability, naming of a "risk" or class of "risks" covered by the policy, warranties as to representations in applications, absolute and partial limitations upon liability, provisions for notice and proof of loss by the insured, and payment thereof by the insurer within a designated time, limitation as to bringing suit, etc.

While the general purpose of such insurance is to furnish the business world protection against loss by extension of credit, the guaranty that is in fact given by the credit insurance companies is limited and controlled by certain specified conditions which are inserted in the policies that are issued. Briefly summarized, these conditions generally relate to the following matters: 1st. To defining insolvency as that term is used in the policy.

2d. Limitation of liability to a certain stipulated amount in the aggregate, and in the case of individual "risks" not to

[1] See Am. Cr. Indemn. Co. *v.* Carrollton Fur. Mfg. Co., 95 Fed. 111; 26 C. C. A. 671.

exceed a certain amount on any one "risk," against loss resulting from insolvency of debtors to the insured over and above an annual net initial loss to an amount stipulated in the policy; such net loss to be borne by the insured on his total gross sales and deliveries of merchandise amounting to a certain named sum or less, such sales and deliveries to be made to firms, corporations or individuals actively engaged in commercial or mercantile pursuits in the United States between certain specified dates.

3d. Sales and deliveries to be confined to such as are made *bona fide* to parties who have a certain designated rating in the current books of Dun or Bradstreet or other commercial agency named in the policy.

4th. No credit account to exceed the amount designated in the policy as permissible for any one debtor.

5th. No claim to be filed under the policy on account of any one insolvent debtor in excess of a certain designated percentage of the lowest amount of the capital rating given by the commercial agency named in such policy.

6th. All initial claims against insolvents after payment of insurance to remain the property of the insured; all others to be the property of the insurer, by right of subrogation after settlement of loss.

7th. Immediate notification of insolvency of the insured's customers, and furnishing of proof of loss in the manner prescribed in the policy.—The foregoing does not, of course, constitute a full statement of all the manifold conditions of credit insurance policies. It will, however, serve to show in a very general way the nature and scope of the business carried on by credit insurance companies in this country. The policy as now issued would seem to be based on sound business principles, requiring the insured to be his own insurer to the extent of bearing an initial loss before recourse can be had by him to his policy of credit insurance, and at the same time limiting the scope of liability to such "risks" as have a fair business rating in the commercial reports.

The basic principle of credit insurance is a division of liability between the insurer and the insured. The insured under such policies undertakes to bear a certain loss before any responsibility attaches to the insurer. The latter does not insure as to the loss assumed by the insured, but only undertakes to insure to a fixed amount after a deduction is made for loss so assumed by the insured.[1] The rate of premium charged is based upon the percentage of the insured's losses to the total business transacted by him on a credit basis during preceding years, as well as upon his value as a moral hazard.

§ 226. **Attachment and Duration of Liability.** — Liability under a contract of credit insurance attaches as of the date designated in the policy for the commencement of liability thereunder. Ordinarily there is no difficulty in ascertaining when such liability attaches, but the determination in all cases of the period of duration of liability under a policy is by no means easy. True it is that in most cases the policy states specifically the period of liability; yet so many circumstances may arise by reason of acts of the parties in violation of the conditions of the policy or because of the use of ambiguous language in the instrument itself, as to render a determination of the period of liability a matter of no little difficulty and doubt. A brief examination of the cases wherein questions relative to the duration of liability under credit insurance policies were considered will now be presented. In Hogg *v.* Indemnity Company,[2] a policy had been issued providing indemnity against loss on total gross sales made between June 15, 1896, and June 14, 1897, inclusive, liability to cease June 14, 1897. By a rider attached, it covered losses occurring after payment of premium on sales and shipments made from April 1, 1896, to June 15, 1896. The policy also provided that claims should be barred unless notice thereof was given within ten days after the insured was informed of a debtor's insol-

[1] See Brierre *v.* Am. Indemn. Co., 67 Mo. App. 384; see also Lauer, *et al.* *v.* Gray, 55 N. J. Eq. 544; 37 Atl. Rep. 53; Gray *v.* Reynolds, 55 N. J. Eq. 501; 37 Atl. Rep. 461.

[2] 172 Mass. 127; 51 N. E. 517.

vency during the term of the policy, and a final statement of claims filed in accordance with this condition was to be made and received at the insurer's office within 30 days after the policy expired. An adjustment was to be made within 60 days after its receipt, and the amount found due was payable at once. In case the policy was renewed, losses on sales covered, resulting after its expiration on shipments made during the term of the policy, could be proven in accordance with the terms of the renewal. On this state of facts the Massachusetts Supreme Court held that it did not authorize a claim for indemnity under the policy for a loss resulting from an insolvency on the part of a debtor to whom the insured had previously sold goods, where such insolvency occurred after the date of expiration of the policy.

Again, in Sloman *v.* Guaranty Company,[1] a policy had been issued wherein indemnity was promised to the insured against loss by insolvency of the insured's debtors owing for merchandise sold between April 1, 1893, and March 31, 1894, the policy to expire by its terms on the date last mentioned. It was further provided that final proofs of losses should be presented within 90 days after the expiration of the policy, and that no loss should be payable unless included in such proofs, except that, should the policy be renewed on expiration, losses occurring after such expiration on sales made during its existence should come within the scope of the insurer's liability. The holding of the Michigan Supreme Court in this case was to the effect that losses occurring after the expiration of the policy on sales made during its existence were payable, though the policy was not renewed, provided the final proof of loss was made as required. In Talcott *v.* Insurance Company,[2] a policy was issued conditioned to indemnify the insured against losses on sales during a certain designated period by reason of the insolvency by legal process of any buyer to whom goods should have been sold and delivered during the specified pe-

[1] 112 Mich. 258; 70 N. W. 886.

[2] 41 N. Y. Sup. 281; 9 N. Y. App. Div. 433; 163 N. Y. 57; 57 N. E. 1125.

riod named in the policy or by reason of any judgment or decree of court obtained for goods so delivered within the said period, upon which execution should have been returned unsatisfied. It was held that the policy did not cover losses on sales made during the specified period where judgment for the price was not recovered until afterwards.

Unlike some other forms of insurance, the effect of renewal provisions in a policy, followed by the issuance of such renewal policy, is, under the peculiar conditions of credit insurance policies, practically to merge the original and renewal policies into one continuing policy for the period of time named in both policies.[1]

By way of limitation upon the period of liability, policies frequently provide that in the event of failure or discontinuance of business on the part of the insured, occurring before the date named for the expiration of the policy, the same shall become void. In a Maryland case the policy had been issued to a firm composed of two partners, and contained the clause just mentioned. After goods had been sold on credit during the term of the policy, but before the " risk " defaulted in his payment therefor, by such copartnership, one of the partners died. Subsequently the partners by whom such goods had been sold became insolvent, and in an action on the policy to recover for losses covered thereby, the court held that the death of one member of the firm was not a discontinuance of the business within the terms of the policy, and that the surviving partner was entitled to recover the losses so incurred.[2]

In an English case, a policy was considered wherein was a condition closely analogous to the one given above. It provided that if any member of the insured (a trading copartnership) should die, or cease to be such trader, the policy issued to them providing against loss by insolvency of customers of

[1] See Am. Cr. Indemn. Co. *v.* Champion Coated Paper Co., 103 Fed. 609; 43 C. C. A. 340.

[2] Am. Cr. Indemn. Co. *v.* Cassard, 83 Md. 272; 34 Atl. 703.

such copartnership should become void upon such death or retiracy.

It was held that the policy became void upon the retirement of one of the partners from trade.[1] So again it is said that the insolvency of the insurer terminates the policy.[2]

In a late case the policy provided, in substance, that it should be enforceable by the insured where the " risk " made a general assignment or went into the hands of a receiver, or, without failing in business, offered to compromise under a compromise approved by the insurer. The " risk," while in the hands of a receiver, offered a compromise to the insured, by giving notes on time, which offer was never accepted or executed. However, the insurer agreed that any ultimate loss on the notes might be readjusted until November 9, 1899, the date of the maturity of the last of the notes, under a clause that provided that where a " risk's " offer of settlement had been deducted on an adjustment and the insured did not subsequently realize the amount of the offer, the loss should be readjusted, provided the estate of the " risk " was settled and the deficiency ascertained within twelve months from the expiration of the policy. The policy expired March 31, 1897, and the deficiency was not ascertainable until 1899.

On this state of affairs it was held, that as the offer of compromise was never carried out nor made the basis of an adjustment, there could be no readjustment under the clause providing therefor, and that the loss was to be computed under the clauses of the policy which governed cases of insolvency.[3]

§ 227. **Scope of Liability.** — In view of the fact that credit insurance has reference to payment of losses arising through the " insolvency " or " failure " of parties to whom credit has been extended by the insured, it is of primary importance to ascertain the meaning of these words as employed in the poli-

[1] Solvency Mut. Guar. Co. *v.* Freeman, 7 H. & N. 17.

[2] See Smith *v.* Nat. Cr. In. Co., 65 Minn. 283; 68 N. W. 28.

[3] People *v.* Merc. Cr. Co., 35 N. Y. Misc. 755; 72 N. Y. Sup. 373.

cies issued. By so doing a long step will have been made towards ascertaining the scope of liability under policies of credit insurance. The question here presented was gone into at length by the Maryland court of appeals in Strouse *v.* American Credit Indemnity Company of New York.[1] In the opinion in that case — which involved the construction of a credit insurance policy — the court spoke as follows:

"This scheme of indemnity includes two classes of losses, the one an initial loss which must be borne by the indemnified, the other a loss in excess of the initial loss, which must be borne by the indemnitor. Both kinds of losses are such as result from insolvency of debtors who owe the indemnified. Obviously the inquiries which first suggest themselves are these: What is meant by the term 'insolvency,' as used in the body of the bond? Which are the losses that belong to the two classes respectively? What is the period of time at which the initial loss must be ascertained? As upon the location of that time the extent of the liability of the indemnitor, in a large measure, depends. It is insisted by the company (the insurer) that the term 'insolvency' is limited and defined by conditions 'II a' and 'II b,' indorsed upon the bond. These clauses are as follows: '(II a) General assignments of or attachments against insolvent debtors, the absconding of the debtors or executions returned *nulla bona*, shall constitute insolvency. (II b) The appointment of a receiver, a sell out, or the death of the debtor does not establish insolvency, but the indemnified may prove such claim during the term of this bond, or renewal thereof, provided legal proof shall be given, establishing the insolvency of the debtor.' These bonds of indemnity and certificates are contracts confined to the business affairs of merchants, and relate exclusively to the insolvency of merchants. Naturally, then, it must follow that the insolvency against which they afford indemnity is 'insolvency' as understood by merchants and as defined in bankrupt and insolvent laws relating to merchants and to mercantile transactions, unless a contrary or different purpose is clearly and unequivocally manifested by some term of the contract. On the face of the bond protection against loss resulting from the insolvency of debtors is afforded. The insolvency designated is the usual legally defined 'insolvency,' which is an inability of the debtor to pay his debts as they fall due in the ordinary course of business, and this is dependent neither upon a formal adjudication nor on an actual insufficiency to meet liabilities. As a defeasance

[1] 91 Md. 244; 46 Atl. 328.

clause limiting the liability of the indemnitor, it must be clearly expressed and strictly construed. Conditions II a and II b cannot be held to narrow the meaning of the term 'insolvency' as used in the body of the instruments. 'General assignments or attachments against insolvent debtors shall constitute insolvency.'

"'The absconding of debtors or executions returned *nulla bona* shall constitute insolvency.' Obviously this means that these things shall constitute evidence of insolvency. It is not every general assignment or every attachment that is declared to constitute insolvency, but such an assignment made by or an attachment issued against an insolvent debtor. But who is an 'insolvent debtor'? Unless you reason in a vicious circle, the answer must be, one who is unable to meet his obligations as they fall due in the ordinary course of business. An execution returned *nulla bona* cannot constitute a debtor's insolvency. Insolvency is a status. The return on execution may be evidence of that status, but is not the status itself. These four things named in clause 'II a' do not create the status or condition of insolvency; they are simply results which flow from the antecedent preexisting insolvency. They are therefore evidence of the thing from which they proceed, they are not the thing itself. Section 116 makes this demonstrably clear. The appointment of a receiver, etc., does not establish, that is, does not prove, insolvency; but legal proof may be given establishing the insolvency of the debtor; that is, establishing his inability to pay his debts as they fall due in the ordinary course of business. Now, if none of the things named in 'II a' constituted insolvency, there could be no legal proof of insolvency under 'II b,' because there could be no insolvency to be proved unless there was a general assignment, an attachment, an absconding, or a return of *nulla bona*. A thing which in its very nature cannot constitute insolvency, though it may constitute evidence of insolvency, cannot, by being called insolvency, be other than it intrinsically is, namely, a means of proving the existence of insolvency. This must be so unless the thing to be proved is identical with the thing that proves it, unless insolvency as a fact and the evidence which proves that it is a fact are one and the same thing. But the two are manifestly different." [1]

Another case wherein this same question was considered, but under a different wording of the policy, is that of Good-

[1] See in this same connection Am. Cr. Indemn. Co. *v.* Carrollton Fur. Mfg. Co., 95 Fed. 111; 36 C. C. A. 671; Am. Cr. Indemn. Co. *v.* Athens Woolen Mills, 92 Fed. 581; 34 C. C. A. 161; People *v.* Merc. Cr. Co., 166 N. Y. 416; 60 N. E. 24.

man *v*. Mercantile Credit Guarantee Company.[1] The policy there under consideration provided that the

"term 'loss sustained by reason of insolvency of debtors' is agreed to mean losses upon sales made by the indemnified to debtors who have made a general assignment for the benefit of their creditors, or who have been declared insolvent in legal or judicial proceedings, or whose business has been sold by the sheriff, marshal or other public officer, under an attachment, execution or other process, or against whom an execution has been returned unsatisfied upon a judgment obtained by the indemnified for sales of merchandise made during the period covered by the contract."

Commenting upon this provision, the court spoke as follows:

"On January 4, 1893, Thayer, the debtor, executed a conveyance of his entire stock of goods, wares and merchandise to a trustee, with directions to sell and apply the proceeds, after payment of fees and expenses, to the payment of nine specified creditors, preferring them in the order in which they were named. The instrument refers in one place to the property transferred as a 'part of his property and effects,' and in another as only 'a part of his property.' On January 11, 1893, Thayer executed another instrument, which recited the former and conveyed any unexpended surplus to the same trustee for the payment, *pro rata*, of eighty-three creditors. The insured rely wholly upon these instruments, which they claim constitute a general assignment for the benefit of creditors. The insured first contends that by 'general assignment' in the policy is meant any such disposition by a debtor of his property as induces insolvency in the ordinary meaning of the term, — as renders it impossible for the insured to realize its claim. This seems to us to be reasoning in a circle. The policy provides for indemnity against losses by 'insolvency,' and then undertakes to define of what insolvency shall consist. This definition is binding upon the parties, and no loss which does not comply with it can be proved against the defendant. But the execution of a 'general assignment' is employed as a test of insolvency. Consequently, to say that such an assignment is meant as produces insolvency is either to say nothing at all or to abrogate the contract definition entirely and adopt one from some outside source which may or may not be like that provided for. 'Assignment' cannot be defined in terms of 'insolvency,' at the same time that 'insolvency' is defined

[1] 45 N. Y. Sup. 508; 17 App. Div. 474.

in terms of 'assignment.' Discarding such a definition, we see no reason why the term 'general assignment' for the benefit of creditors should not be given its ordinary legal significance."

The New York court of appeals had occasion recently to consider this same question in People *v.* Mercantile Credit Guarantee Company.[1] It was there held that written transfers, by which debtors convey substantially all their property to pay or secure debts, the property being at once delivered and the debtors thereupon ceasing to do business, constitute general assignments for creditors within the meaning of a policy prepared for use, not in any particular state or locality, but throughout the country generally, insuring against loss or sale sustained by the insolvency of debtors who have made a general assignment for the benefit of their creditors, whether the assignment be in the form prescribed by state statutes or an assignment at common law, or for the benefit of a single creditor or all. The question before the court involved a construction of the policy or contract which the company delivered to the claimants and which the latter insisted entitled them to payments from the assets in the hands of the receiver.

"It will be convenient," observed the court, "to consider the two claims separately, since the policies and the conditions governing the rights of the parties are different. The claim of the Winsted Hosiery Company amounts to $364.24, made up of three distinct items or debts due the claimant from three different customers for goods sold; namely, one Getz, $101.70; one Moses, $176.14; and Robie & Co., $86.40. The two former debtors are in Texas and the latter in Illinois. By the terms of the policy the defendant, in consideration of $90, insured the hosiery company 'to an amount not exceeding $3000 against loss sustained by reason of the insolvency of debtors owing the insured for merchandise usually dealt in, sold and delivered in the regular course of business.' The policy contains numerous conditions and stipulations which qualify the general obligation of the insurer, but we are now concerned with only one of those conditions, which was as follows: 'The term "loss sustained by the insolvency of debtors" is agreed to mean losses upon

[1] 166 N. Y. 416; 60 N. E. 24.

sales made by the insured to debtors who have made a general assignment for the benefit of their creditors.' The question therefore is, whether, upon the facts found, the three debtors named to whom the insured sold goods and failed, made a general assignment for the benefit of their creditors within the fair meaning of this provision of the defendant's policy. They did make written transfers, respectively, of substantially all their property to pay or secure their debts, and the question certified is whether either of the three instruments appearing in the record constitute a general assignment within the meaning of the policy 'when, at the time of their respective execution, the property severally described therein constituted substantially all the property of the respective debtors and was at once delivered and the respective debtors thereupon at once ceased to do business.'

"The other claim was presented by Daniel Forbes Company of Chicago, under a different policy, involving the meaning of other conditions. The general purpose expressed is the same as the policy just considered, and it expired on the 30th of April, 1897. The claim was rejected on the ground that it had not accrued within the life of the policy. It amounts to $441.97 for goods sold to an insolvent debtor, and it is claimed that the following conditions of the policy exclude it from sharing in the assets held by the receiver: (1) 'Only such amounts as are actually owing by an insolvent debtor to the insured at the date of his insolvency shall be taken in the calculation of the losses under this policy, and only when this debtor has made a general assignment for the benefit of his creditors, or has been declared insolvent in legal or judicial proceedings, or an execution has been returned unsatisfied on a judgment obtained against him by the insured, or some other creditor, for merchandise sold to said debtor during the period covered by this policy, provided said execution has not been returned after the appointment of a receiver or trustee of the property of the debtor.' (2) 'This policy shall expire on the 30th of April, 1897, and any loss by reason of the insolvency of any debtor after said time shall not be provable hereunder.' (3) 'Final verified proofs of loss must be presented to the company within sixty days after the expiration of the policy, and no loss is payable unless included in such proofs presented within that period. Losses to be adjusted and paid within sixty days after final proofs.'

"The claimant's debt was for goods sold, and judgment was recovered thereon and execution issued twelve days before the policy expired, but the execution was not returned unsatisfied until three days after; that is, on May 3, 1897, and the question certified to us is: 'Did the return of the execution unsatisfied on May 3, 1897, con-

stitute it an insolvent debtor, for which the company was liable under the terms of the Daniel Forbes policy?' I think that this claim is fairly within the indemnity provided by the policy.

"(1) The conditions require that the judgment be obtained 'for merchandise sold to said debtor during the period covered by this policy.' That condition is satisfied by the facts of this case.

"(2) Any loss by reason of the insolvency of the debtor after the expiration of the policy is not provable. That means that the loss and the insolvency must occur within the year covered by the policy. Both facts did occur within that time in this case.

"(3) There is no express limitation in the policy with respect to the time when the execution is to be returned, except that it must not be returned 'after appointment of a receiver or trustee of the property of the debtor.' That did not happen in this case.

"(4) The only limitation in the policy concerning the return of the execution is implied in the condition that final verified proofs of loss must be presented within sixty days after the policy expires, and no loss is payable unless included in such proofs submitted within that time. It may be possible that unless the execution is returned within the sixty days limited for presenting final proofs that the insured will not be able to make proofs of his claim. But in this case the return was made within three days after the policy expired, so that the insured could and did present the claim in his proofs. To sustain the decision under review it is necessary to hold that not only must the goods be sold within the life of the policy and the judgment rendered and the execution issued, but that it must be returned unsatisfied within that time, which is one year, and that, too, when there is no language in the policy or in the conditions which would warrant such a construction. It would reverse the legal rule for the interpretation of such conditions and require us to hold that they are not to be construed liberally in favor of the insured, but strictly against him, by importing into the contracts words that the parties have not used. The return of the execution does not constitute the main fact of the insolvency, but it is simply evidence of that fact, and if the insured, when presenting his proofs of loss within the time stipulated, can show that it has then been returned, that is a compliance with the terms of the policy. The contention that the goods must be sold, judgment recovered, execution issued, and returned unsatisfied, all within the year, would defeat in most cases every purpose of the insured in entering into the contract and destroy all benefits to be derived by him under it. The sheriff in this state has sixty days within which to return the process, and perhaps in other states even a longer time,

and if the insurer can be held only on such judgments and executions as have been returned unsatisfied within the year when the goods are sold, the indemnity to the insured is a delusion. It is very clear that no such construction should be adopted unless the language employed admits of no other. When the conditions of this policy are carefully read, it will be seen that such an extreme and destructive stipulation is not to be found. No language has been employed to limit the liability of the insurer to debts upon which an execution has been returned unsatisfied within the year, and that proposition comprehends the whole question. Such a limitation cannot be based upon conditions that are obscure or of doubtful meaning."

A most instructive case on the scope of liability under renewal policies is American Credit Indemnity Company *v.* Champion Coated Paper Company.[1] The facts in this case, so far as they relate to matters of construction, were as follows: Two bonds of indemnity against loss by the insolvency of debtors were issued to a mercantile company, the second being a renewal of the first. They contained identical provisions to the effect that any loss covered by the terms of such bond and resulting from sales and shipments made during its term, but which should not become provable under its conditions before its expiration, might be proved under a renewal thereof, "under and subject also to the terms and conditions of such renewal," and also in case such a bond was a renewal, losses occurring during its term on sales and shipments made during the term of the preceding bond might be proved thereunder, subject also to the terms, conditions and limitations of such preceding bond. It was held that under such provisions one evident purpose of a renewal was to extend the protection of the preceding bond to losses on sales during its period which did not technically become provable before its expiration, and hence that such losses from sales and shipments made during the term of the first bond and proved during the term of the second were governed by the terms and conditions of the original bond, rather than those of the renewal, as to matters wherein the two differed.

[1] 103 Fed. 609; 43 C. C. A. 340.

A somewhat analogous question was before the court in Strouse *v.* American Credit Indemnity Company.[1] Here the policy had a "rider" attached to it, whereby similar losses, provable under a renewal of a prior lapsed policy, were allowed to be proved under the later policy, in accordance with its terms and conditions. The lapsed policy had guaranteed the insured against losses in excess of an initial loss of $6250, and provided that losses occurring after its expiration on goods shipped during its continuance should be provable under a renewal of it. On this state of facts the court ruled that only such losses as were in excess of the initial loss of $6250 were provable under the policy, the provisions of the original lapsed policy as to such initial loss being regarded as incorporated in the later policy, and the provision as to the terms and conditions of the latter relating only to the mode of proving such claims.

It sometimes becomes a matter of importance, in connection with the payment of claims, to determine whether or not certain parties come within the list of "risks" covered by the policy. This is a question exclusively for the jury to determine, under proper instructions from the court.[2]

Where the policy stipulates that no loss shall be proven after its expiration, except that, in case the same is renewed and the premium on such renewal paid at or before the expiration of the policy, loss resulting after such date of expiration on shipments made during the terms of such policy may be proven during the term of the renewal policy next immediately succeeding, the question as to what constitutes insolvency is governed by the terms of the first policy and not by those of the renewal, under which the insolvency occurred and loss was proved.[3]

§ 228. **Discharge of Liability.** — As in other and kindred forms of insurance, the insurer in credit insurance contracts

[1] 91 Md. 244; 46 Atl. 328.

[2] Strouse *v.* Am. Cr. Indemn. Co., 91 Md. 244; 46 Atl. 328.

[3] Am. Cr. Indemn. Co. *v.* Athens Woolen Mills, 92 Fed. 581; 34 C. C. A. 161.

may be discharged from liability in a variety of ways. Chief among these may be mentioned the following:

1. By rescission of the contract or by cancellation of the policy.
2. By misrepresentation on the part of the insured.
3. By concealment on the part of the insured.
4. By breach of warranty on the part of the insured.
5. By breach of conditions on the part of the insured.
6. By payment of loss by the insurer to the insured.

§ 229. **Discharge of Liability by Rescission or Cancellation.** — There can be no doubt but what the ordinary principles of fraud relative to the right of cancellation, where the same is practised in connection with the formation of the contract, are applicable to credit insurance. The policy may be cancelled at any time by mutual consent, and usually by either party where no liability has been incurred.[1] Incidentally, in this connection, it may be observed that in the case of mutual credit insurance companies formal written notice of retirement from such companies is usually required to relieve the withdrawing member from future liability of any nature.[2] Again, it has been held that where the insurer fails during the life of a policy, and no liability has been incurred thereunder, the insured cannot, as against a receiver of such insolvent company, recover back the whole premium paid, but only the unearned premium for the balance of the year subsequent to the insolvency of the insurer.[3]

In one case the right to rescind a policy for a fraudulent concealment of the insolvency of a customer was held barred by laches, through delay of the insurer in seeking to rescind the same after notice of such insolvency.[4]

[1] See *ante*, §§ 49, 50.

[2] See *In re* Insolv. Mut. Guar. Soc., 10 W. R. 572; Solv. Mut. Guar. Co. *v.* York, 3 H. & N. 588; Solv. Mut. Guar. Co. *v.* Froane, 7 H. & N. 5; Solv. Mut. Guar. Co. *v.* Freeman, 7 H. & N. 17.

[3] Smith *v.* Nat. Cr. Ins. Co., 65 Minn. 283; 68 N. W. 283.

[4] Am. Cr. Ins. Co. *v.* Wimpfheimer, 43 N. Y. Sup. 909; 14 N. Y. App. Div. 498.

§ 230. **Discharge of Liability by Misrepresentation.** — The custom prevalent in credit insurance companies of requiring all parties seeking this form of insurance to fill out blank applications for policies, wherein are contained a large number of inquiries relative to the past business history of the insured, as well as searching queries as to the extent and condition of his business at the time such application is forwarded to the insured, renders the subject of misrepresentation of considerable importance in credit insurance law. However, as it is the practice to insert in both the application and the policy provisions making all the representations contained in such applications warranties, most of the legal questions thereby presented will be discussed under that head.[1] However, attention is called to one case, where the subject of misrepresentations was gone into at some length.

Here an application for a credit guaranty policy placed the applicant's gross sales during the preceding fourteen months at $622,835, and his losses at $1323. The insurer agreed to buy from the insured an amount not exceeding $15,000 of uncollectible debts arising during the period of liability covered by the policy owing for goods sold and delivered in excess of one-half of 1 per cent on the total gross sales and deliveries made during that time, subject to the terms and conditions attached to the policy. One of these stated that the policy was issued on the basis that yearly sales and deliveries of the insured were between $1,800,000 and $2,500,000. This last clause was not treated as a warranty, and for that reason did not have the effect of exempting the insurer from liability if the insured's total sales on which the half of 1 per cent was to be computed failed to reach $1,800,000; therefore the insured was allowed to recover his losses not exceeding $15,000 in excess of that *ratio* on his actual total sales during the period of liability.[2]

[1] See *post*, § 164.

[2] Tebbetts *v.* Merc. Cr. Guar. Co., 73 Fed. Rep. 95; 19 C. C. A. 281; see also Baer, *et al.* *v.* Am. Cr. Indemn. Co., 101 N. Y. Sup. 672; App. Div. .

A representation in credit insurance is satisfied if it is substantially true. That is, if it is so far true that the conduct of the insurer would not have been different if the exact truth had been represented, and whether the representation is substantially true or substantially false, is a question for the jury.[1]

In Carrollton Furniture Manufacturing Company *v.* American Credit Indemnity Company[2] the court had occasion to consider the effect of the Kentucky statute providing that all representations contained in a policy of credit insurance should be construed as representations and not warranties, even though the applicant warrants the answers to be true. The facts in this case, briefly stated, were as follows: A credit insurance company had issued a credit insurance policy to the insured against losses as well to debtors having a rating as to capital and credit in the last published report of R. G. Dun and Company. The application, which was made part of the contract of insurance, contained the question: "What have been your gross sales and gross losses each year during the last five years?" The insured, in answer to this question, stated its actual losses during the said period at an amount greatly below what they actually had been. The court held first, that the question "What is a material representation?" is a matter of law. It also held that a material representation will affect an insurance policy, though made by mistake and not with fraudulent intent. The insured offered evidence that the insurer's agent told him the question referred to above called for information as to losses on sales to debtors having a mercantile agency record, and that the answer directly stated the amount of such losses.

The court held that if the incorrect answer was induced by the agent's misconstruction of the question, the insurer was estopped to claim that it affected the policy. "It is imma-

[1] Carrollton Fur. Mfg. Co. *v.* Am. Cr. Indemn. Co., 124 Fed. 251.
[2] 115 Fed. 77.

terial," the court observed, " whether a misrepresentation has been made with fraudulent intent or by interpretation or mistake, if it has been one which induced the insurer to enter into the contract, and an immaterial misrepresentation, unless in reply to a specific inquiry or made with fraudulent intent, known to either party, will not impair the contract. But if the liability is greater than it would have been if the representation had been true, such untruth will relieve the insurer from liability under the policy, even if the representation was honestly made." Where a doubt exists as to the materiality of the representation, it is ordinarily a question of fact for the jury. But in this case, having been made in reply to a specific inquiry and warranted to be true, and having been in respect to a fact which certainly had an important bearing in estimating the extent of loss, the court held that it was material as a matter of law.

§ 231. **Discharge of Liability by Concealment.** — In view of the character of credit insurance, wherein the personalities of the " risks " insured against are necessarily unknown as well as numerous, there is but small opportunity for an extended application of the doctrine of concealment to this branch of guaranty insurance law. For a presentation of such doctrine, the case of American Credit Insurance Company *v.* Wimpfheimer, *et al.*[1] may be referred to. Here the failure of the insured under a credit indemnity policy to inform the insurer at the time of obtaining a renewal that a customer to whom sales had been made by the insured during the life of the original policy was insolvent, and that an application for a receiver was pending, was held not to be such a fraudulent concealment as served to avoid the policy, if the renewal was taken at the insurer's instance.

The renewal bond was drawn according to the same terms and conditions as the original, save as to the amount of initial loss. The court, in passing upon the questions thus presented, spoke as follows:

[1] 43 N. Y. Sup. 909; 14 N. Y. App. Div. 498.

"The plaintiff is engaged in the business of insuring merchants against loss by insolvency of debtors. This particular class of insurance is of recent origin, but the principles which must govern the construction of the bond are not new." "Fraud in the suppression of a material fact arises only where one party to the contract fraudulently and intentionally conceals from the adverse party something which he knows, and the other party does not know, and which the first party was bound to state, the suppression of which has induced the adverse party to enter into the contract. Suppression *veri* or concealment will amount to fraud where the concealment is of material facts, where there is such a relation of trust and confidence between the parties that the one party is under some legal or equitable duty to give full information to the other, and which the latter has a right, *juris et de jure*, to know, and then the withholding of such information purposely may be a fraud. Where the parties deal at arms' length, on equal terms, and no particular relation of trust or confidence exists between them, there is usually no obligation, and either may remain silent and be safe."

§ 232. **Discharge of Liability by Breach of a Warranty.** — In discussing the doctrine of warranty in this immediate connection, the first question that naturally presents itself is this: Has the doctrine of warranty, as developed in the law of fire, life and marine insurances, been adopted into the law of credit insurance, either in whole or in part? In answer to the question, attention is called to a decision of the United States circuit court of appeals for the second circuit, — that of American Credit Indemnity Company *v.* Carrollton Furniture Manufacturing Company,[1] — where the court spoke as follows:

"In the application for insurance the plaintiff (the insured) warranted the answers to the questions asked by the defendant (the insurer) to be true, and offered these answers as a consideration for the policy to be issued. The policy subsequently executed declared that it was issued in consideration of the application, which was made part of the contract of indemnity. The answer to the question in regard to gross sales and gross losses was that for each of three years ending in July, 1891, 1892 and 1893 the gross sales were about $100,000. The actual sales for these years were $87,441.61, $99,990.65, and

[1] 95 Fed. 111; 36 C. C. A. 671.

$97,831.06. The gross losses stated in the answer for the same years were $498.90, $1,040.26, and $818.22. The losses as claimed by the defendant (the insurer) for those years were $3,080.74, $2,275.17 and $1,334.59. The important question upon this point was in regard to the amount of losses for the year ending in July, 1891, which the defendant claimed had been reduced to about $1680, and there was vague testimony about an additional reduction of small amount. The defendant asked the court to charge that the written answers to the questions in the application were express warranties upon the faith of which the policy was given, and if untrue, the materiality of the same was unimportant, and if not strictly performed, that the plaintiff could not recover. The court charged that if there was a substantial misrepresentation as to the facts at the time the application was made, the plaintiff was not entitled to recover; but if the differences were unsubstantial and immaterial, such differences would not stand in the way of its recovery, and if the difference was between $498.90 and $3,080.74, that would be a material and substantial variation from the amount stated in the application, and would defeat the plaintiff's right to recover. The request in regard to the necessity of strictness in performance of a warranty was not complied with, and probably from the fact that as the policy also made misrepresentation and concealment matters in avoidance, the difference between a warranty and representation was not sharply pointed out. The application contains an unequivocal warranty, and by the express terms of the policy became a part of the contract. Courts have been reluctant to import terms of warranty which were contained in the application or proposal for insurance into the completed agreement, unless the policy clearly manifested the agreement of the parties to the union of the two papers in one contract; but where there is a distinct agreement that the application is a part of the contract, and the statements in the application upon which the contract is based are expressly declared to be warranties, the intent of the insured to bind himself to exactness of truth in his answers, although the facts which are called for may seem not material, is clearly and adequately manifested, and the contract must be enforced according to its terms. Where the assertions or representations upon which the contract is declared to be based are warranties, they must be strictly true, or the policy will not take effect; and this is so whether the thing warranted be material to the risk or not. It would perhaps be more proper to say that the parties have agreed on the materiality of the thing warranted, and that the agreement precludes all inquiry into the subject. The answer in regard to the amount of gross sales was

expressed to be approximate, but in regard to the amount of gross losses, which were the result of the business for the year ending in July, 1891, the answer professed to be exact; and the question of a breach of warranty, if any question really existed rather than that of misrepresentation, should have been submitted to the jury. If no question could exist in regard to the fact of a breach, as would be the case if the actual loss was $1680, instead of $498, there was no liability under the policy."[1]

Undoubtedly where the policy recites that it was issued in consideration of the application and the statements therein contained, and warrants these to be true, then, under such circumstances, these statements constitute warranties. A warranty in credit insurance as well as in other branches of insurance law is in the nature of a condition precedent, and devolves upon the insured the burden of averring performance thereof in his pleading, and of proving the same strictly at the trial.[2]

Ordinarily reference is made in writing in an application for credit insurance in response to written questions and warranted by the applicant to be true from the basis of the contract of credit insurance, and are thus made material by the action of the parties in so treating them. A warranty in an application for credit insurance must be legitimately and exactly fulfilled.[3]

An application for a credit insurance policy recited that it was part of the proposed contract of credit insurance, and that it was made by the applicant or his known agent. As a matter of fact, it was prepared by the local agent of the insurer who was without power to issue the policy, and whose name did not appear thereon. The questions in the application were not technical, and the insured was not obliged to accept the policy. The court held that the knowledge of the agent of the insurer that an incorrect statement had been inserted in the application as to the past business losses of the

[1] To the same effect, see Am. Cr. Indemn. Co. *v.* Wood, 73 Fed. 81; 19 C. C. A. 264; see, however, Tebbetts *v.* Merc. Cr. Guar. Co., 73 Fed. 95; 19 C. C. A. 281.

[2] Am. Cr. Indemn. Co. *v.* Wood, 73 Fed. 81; 19 C. C. A. 264.

[3] Carrollton Fur. Mfg. Co. *v.* Am. Cr. Indemn. Co., 124 Fed. 251.

insured on which the terms of the policy were based, could not be imputed to the insurer so as to base a claim of estoppel thereon.[1]

An accepted tentative offer by an adjuster of a credit insurance company to settle a claim for less per cent by the insured if the latter would accept less than the face of the claim for a cash settlement, if made in ignorance of the existence of a material breach of warranty on the part of such insured, cannot be held to constitute a waiver thereon.[2]

§ 233. **Discharge of Liability by Breach of Conditions.** — To all forms of credit insurance policies a large number of conditions will be found attached, either in the body of such policies or in the form of "riders" annexed thereto. The rulings of the courts as to the principal conditions here referred to will now be presented. First, attention should be called to the rule that all such conditions should be strictly construed against the insurer.[3]

Where a policy against loss in a certain ratio had been issued, containing a stipulation that only losses incurred by sales to persons whose capital, as well as credit, was rated in "Bradstreet's," should come within the scope of the insurer's liability under the policy, it was held that a loss of the kind mentioned arising from the failure of one of the insured's customers was not within the policy, as the capital of such customer was not rated in "Bradstreet's."[4]

Again, in another case, a credit indemnity policy provided that the insurer should not be liable unless the insured's debtor had a certain rating in a mercantile rating book. In this book one of insured's customers was given a satisfactory rating under the name of the city in which he had a business house, and under the names of other cities in which he had branch houses the names of such houses were given with "See B," referring to the first-mentioned city. It was held

[1] Baer, *et al.* *v.* Am. Cr. Indemn. Co., 101 N. Y. Sup. 672; App. Div.

[2] *Idem.*

[3] Am. Cr. Indemn. Co. *v.* Cassard, 83 Md. 272; 34 Atl. 703.

[4] Robertson *v.* U. S. Cr. Sys. Co., 57 N. J. L. 12; 29 Atl. 421.

that there was evidence sufficient to go to the jury on the question of the rating of such debtor.[1] One of the valid implied conditions of credit insurance policies is that the insurer shall only be liable for losses accruing directly to the insured, through credit sales made by the latter during the period of liability. In other words, there must be a legal identity between the insured and the party making the sales upon which the claim for loss under the policy is based.[2] Under such circumstances, the question of identity is one of fact for the jury to determine.[3] A condition requiring the payment of the premium as a condition precedent to the insurer's liability under the policy is reasonable and valid.[4] But the insurer may by its conduct estop itself from setting up the failure to pay the premium.[5] Where a credit insurance policy contains a provision that where the insured shall hold other security or indemnity, the amounts realized therefrom shall be deducted before the loss under such policy shall be adjusted, the same does not entitle the insurer to deduct the proceeds of a policy in another company, which provides in terms that it shall not cover losses insured by the first company, but shall only attach when that company's policy is exhausted.[6]

Where a "rider" attached to a policy provided that in case a customer was not rated "within the system" of the insurer by the mercantile agency designated therein, but was rated by another specified mercantile agency, that then losses suffered on his account should be covered by the policy, the latter will, even though the insurer's "system" requires a rating as to both capital and credit, cover a customer who is rated by the agency designated by the policy only as to credit, but by the other agency as to both capital and credit.[7]

[1] Strouse *v.* Am. Cr. Indemn. Co., 91 Md. 244; 46 Atl. Rep. 328.

[2] Am. Cr. Indemn. Co. *v.* Wood, *et al.*, 73 Fed. 81; 19 C. C. A. 264; Strouse *v.* Am. Cr. Indemn. Co., 91 Md. 244; 46 Atl. 328.

[3] Strouse *v.* Am. Cr. Indemn. Co., 91 Md. 244; 46 Atl. 328.

[4] See *ante*, § 88.

[5] See Am. Cr. Indemn. Co. *v.* Champion Coated Paper Co., 103 Fed. 609; 43 C. C. A. 340.

[6] Am. Cr. Indemn. Co. *v.* Wood, *et al.*, 73 Fed. 81; 19 C. C. A. 264.

[7] Shakman *v.* U. S. Cr. Sys. Co., 92 Wis. 366; 66 N. W. 528.

Where a policy contained definitions of insolvency, and at the same time required the insured to give notice within a designated time of the insolvency of a debtor on blanks furnished for that purpose, but which contained no reference to insolvency, and required the insured to answer questions as to the "failure" of the debtor, it was held that the word "failure" was used in a commercial sense.[1]

In a federal case[2] the policy provided that the insured should make proof of loss within twenty days after obtaining knowledge of the insolvency of any one "risk." The insured, within three days after a receiver had been appointed for a certain "risk," notified the insurer upon one of the blanks furnished for this purpose that the "risk" had made an assignment. Five days later an amended proof of loss was made, notifying the insurer that a receiver had been appointed and giving details as to the "risk's" account with the insured. A final proof of loss covering all losses sustained by the insured through failure of all the several "risks" covered by the policy was furnished six months later. It was claimed that the insured had failed to make proper proof of loss within the twenty days. In passing adversely on this contention, the federal court of appeals observed that "no better evidence of the supposed insolvency of the debtor could have been supplied than was furnished by the first proof of loss. The provision (in respect to furnishing proof of loss within twenty days) is intended, not to require formal proof of insolvency, but to afford the insurer prompt notice that a loss has happened, for the purpose of investigation and measure of protection. Occupying as it does the position of a surety, the insurer is entitled to subrogation, and upon paying a loss is entitled to a transfer of the claim against the debtor. The meaning of this condition is that the insurer shall have prompt notification of a probable loss, and in that behalf shall have proof

[1] Am. Cr. Indemn. Co. *v.* Carrollton Fur. Mfg. Co., 95 Fed. 111; 36 C. C. A. 671.

[2] Am. Cr. Indemn. Co. *v.* Wood, *et al.*, 73 Fed. 81; 19 C. C. A. 264.

within twenty days after the indemnified has reason to suppose a debtor to be insolvent. What was done by the insured was in compliance with both conditions with respect to proof of loss. The earlier proof informed the insurer of the failure of the debtor. Their final proof was in all respects sufficient." [1]

Another credit indemnity policy provided that "proofs of loss must be made within twenty days after knowledge of the insolvency of any debtor shall have been received by the indemnified, otherwise such claims shall be barred." Another condition was to the effect that the first losses up to a certain sum should be borne by the indemnified before any claim should be made upon the insurer. It was held, that the failure to give notice of a loss, although the loss came within the second condition, relieved the insurer from liability for it.[2]

It was said in a late case that failure to return an execution until three days after the expiration of a credit insurance policy will not relieve the insurer from liability on the claim upon which it is based, under a condition in the policy limiting liability to cases "where an execution has been returned unsatisfied on a judgment obtained . . . for merchandise sold to said debtor during the period covered by the policy," where the other requirements are complied with, and the only applicable requirement as to returning the execution is the implied one that it shall be before the expiration of the time fixed for presenting final verified proofs of loss, which is done.[3]

In another case the policy provided that final proofs of loss should be furnished within ninety days after the expiration of the policy, and that no loss should be payable unless included in such proofs, except that, should the policy be renewed on expiration, losses occurring after such expiration on sales

[1] As to probative effect of proof of loss, see Sloman *v.* Merc. Cr. Guar. Co., 112 Mich. 258; 70 N. W. 886.

[2] Jaeckel *v.* Am. Cr. Indemn. Co., 34 N. Y. App. Div. 565; 54 N. Y. Sup. 505.

[3] People *v.* Merc. Cr. Guar. Co., 166 N. Y. 416; 60 N. E. 24.

made during its existence were payable. On this state of facts the Michigan Supreme Court held that losses occurring after the expiration of the policy on sales made during its existence were payable, though the policy was not renewed, if final proof of loss was made as required.[1] In Talcott *v.* Credit Insurance Company,[2] the court was called upon to construe a policy providing indemnity to the insured against losses on sales by reason of the insolvency, by legal process, of any buyer to whom goods should have been sold and delivered during the period of the policy, or by reason of any judgment or decree of court obtained for goods so delivered, within the said period of the policy upon which execution should have been returned unsatisfied. It was held, that the policy did not cover losses on sales made during the specified period, where judgment for the purchase price thereof was not recovered until afterwards.

Where a policy provided that final proof of loss should be forwarded to the insurer, and the amount due from the latter under final proof of loss should be adjusted and paid within sixty days after receipt by the insurer of such final proof of loss, the latter is not entitled to deduct from the amount to be paid by it, payments made by the debtors within the sixty days on account of indebtedness included in such final proof of loss, especially where the policy contains a provision that no loss can be proven after the expiration thereof.[3]

Where the original policy insured against credit losses for one year, and provided that there should be deducted from such losses, as an initial loss to be borne by insured, a certain percentage of the total gross sales during the year, and attached to such policy was a "rider" which did not provide for any such deduction, but expressed that it should cover all losses for the year preceding that named in the policy except

[1] Sloman *v.* Merc. Cr. Guar. Co. of N. Y., 112 Mich. 258; 70 N. W. 886.

[2] 41 N. Y. Sup. 281; 9 N. Y. App. Div. 433.

[3] Jaeckel *v.* Am. Cr. Indemn. Co., 34 N. Y. App. Div. 565; 54 N. Y. Sup. 505.

those of which insured had had notice, or those sustained prior to a specified time, or cases where an extension had been granted to the debtors for goods sold during such time, it was held, that the deduction first stated could not be imported into the "rider."[1]

A policy against loss through the insolvency of debtors to the extent of $20,000 over and above a net loss of $7500 to be first borne by the insured on total gross sales and deliveries amounting to $1,600,000, provided that such sum of gross loss should be the limit to be borne by the insured, and that all claims making up such sums of gross loss should remain his property. It also required that insured should make two proofs of loss, — one within twenty days after knowledge of any debtor's insolvency, the other within twenty days after the expiration of the policy. It was stipulated in the clause requiring the last proof that the amount due thereunder should be adjusted and paid within sixty days after receipt of such final proof of loss. Under this state of facts it was held, that the insurer's liability was lessened by a payment made by an insolvent debtor before the expiration of the policy, and that such debt was not to be regarded as a part of the initial loss.[2]

While it is true that any and all conditions may be waived by the insurer if it sees fit to do so, nevertheless mere silence by not replying to a letter concerning a loss is not a waiver of a specific requirement where the contract provides that silence shall not waive any defect in the notice, and that changes in the conditions of the policy must be written and signed by designated officers.[3] It has been held, by at least one court of high authority, that where the policy does not forbid a compromise of debts covered by the policy, and it is not shown that the insurer was in any way injured by such

[1] Goodman *v.* Merc. Cr. Guar. Co., 17 N. Y. App. Div. 474; 45 N. Y. Sup. 508.

[2] Strouse *v.* Am. Cr. Indemn. Co., 91 Md. 244; 46 Atl. Rep. 328.

[3] Am. Cr. Indemn. Co. *v.* Carrollton Fur. Mfg. Co., 95 Fed. Rep. 111; 36 C. C. A. 671.

compromise, nor that more money could have been secured from the debtor than was obtained by compromising, the insurer cannot insist that he is relieved of responsibility because some of the debts were compromised.[1] Still again where the policy provides that loss on claims made under the policy, which were under extension at the time of the payment of the premiums therefor, should not be included in the calculation of losses, the mere taking of notes as evidence of antecedent debts is not to be treated as an extension within the meaning of such policy, though such notes matured at a later date than the open accounts for which they were substituted.[2]

§ 234. **Discharge of Liability by Payment of Loss.** — The fact of there being a liability of some amount admitted by the insurer, the question then arises as to the exact extent of such liability. This, under the peculiar and somewhat ambiguous language of the earlier credit insurance companies, has so far been a task of no small difficulty. There are many cases bearing upon the question of the discharge of liability by payment of loss, and these will now be referred to. It will be observed from a reading of these cases that the principal difficulty experienced in arriving at a decision therein has arisen out of the ambiguous and obscure wording of the policy with reference to the method of ascertaining the amount of loss to be paid and the means to be employed in adjusting the proportions of the loss to be borne respectively by the insurer and the insured.

It seems entirely clear that where the insured has settled a claim against a "risk," whose account has been insured, directly with such "risk," that such settlement is a bar to any claim thereafter on account thereof on the part of the insured against the insurer.[3]

Where the policy expressly provides that, in adjusting losses and before determining the percentage thereof to be borne by insurer, there shall be deducted all sums paid, offered and

[1] Strouse *v.* Am. Cr. Indemn. Co., 91 Md. 244; 46 Atl. 528.

[2] *Ibid.*; see also Am. Indemn. Co. *v.* Wood, 73 Fed. 81; 19 C. C. A. 264.

[3] See Schattman *v.* Am. Cr. Indemn. Co., 34 N. Y. App. Div. 392; 54 N. Y. Sup. 225.

accepted, settled or secured, and the value of any security or collateral held by insured, etc., and that when only a part of the loss is secured by it, the proportionate amount of everything realized or secured by insured shall be credited to so much of it as the policy covers, it is said that the word "loss" does not mean the amount of indebtedness due from the insolvent at the time of his suspension or failure, but the balance of his indebtedness after deducting from the entire indebtedness the payments made by the "risks" prior to adjustment under the policy.[1]

With respect to the meaning of the term "loss" in credit insurance policies the federal and state courts in New York do not seem to be agreed. In Mercantile Credit Guaranty Company of New York *v.* Wood, *et al.*[2] the policy issued insured to the holder an amount not exceeding $10,000 against loss sustained by reason of the insolvency of debtors owing the insured for merchandise. It also contained, besides provisions as to loss to be first borne by the insured, etc., a provision that in adjusting losses, before determining the percentage of loss to be borne by the insurer, there should first be deducted all sums paid, offered and accepted, settled or secured, and the value of any security or collateral. It was held that the "loss" insured against meant, not the whole amount due from an insolvent debtor at the time of his suspension, but the amount remaining due after deducting from such indebtedness any payments made by the debtor, and that a clause in the policy providing that when only a part of a loss was covered by it the proportionate part of everything realized should be credited to so much of the loss as the policy covered, did not change such meaning; but if said clause did not refer to the case of the insured's holding other insurance, and introduced an ambiguity, the doubt should be resolved against the insurance company which prepared the policy. The appellate division of the New York State

1 Merc. Cr. Guar. Co. *v.* Wood, 68 Fed. Rep. 529; 15 C. C. A. 563.
2 68 Fed. 529; 15 C. C. A. 563.

Supreme Court in the case of Goodman, *et al.* *v.* Mercantile Credit Guaranty Company of New York[1] arrived at a conclusion — however, with expressed regret — totally opposed to that of the federal court given above.

In the case of American Credit Indemnity Company *v.* Champion Coated Paper Company[2] a policy had been issued which guaranteed the insured against loss not exceeding $20,000 resulting from the insolvency of debtors "over and above" a loss of $2000 first agreed to be borne by the said insured. It further provided that the claims provable under the policy should include only the amount to be first borne by the insured and the amount of the bond, and that no amount against any one insolvent debtor should be covered for more than $10,000. Under such provisions, it was said the initial loss to be borne by the insured must be deducted from the amount of "covered" or "provable" loss which would require the aggregate amount of such covered loss to be $22,000 to authorize a recovery of the full amount of the policy. It was also held, under a clause of this same policy, providing that when the amount of a claim against any debtor at the time of insolvency exceeds the amount covered thereby, all amounts realized or secured therefrom should be deducted *pro rata*, the insurer is entitled to have credited an amount paid the insured by a third person in settlement of a suit brought to charge him with liability for the debt as a partner for the amount realized upon the claim.

Under a policy agreeing to indemnify the insured against losses by sales and deliveries in his business in excess of one-fourth of one per cent of his annual sales and deliveries to an amount not exceeding $10,000, "save such sum or sums as shall be deducted therefrom as hereinafter provided," it was stipulated that "in the computation of losses, when final adjustment hereinunder is made, no loss on any one claim shall be included in excess of thirty-three and one-third per

[1] 45 N. Y. Sup. 508; 17 N. Y. App. Div. 474.
[2] 103 Fed. 609; 43 C. C. A. 340.

cent of the lowest capital rating" in a certain reference book, "and in no event shall claims of loss exceed $7500 on any one individual or firm"; also, "that in the computation of indemnity under this bond for which the insurer is liable, first, twelve per cent shall be deducted from the total gross losses as calculated under the provisions of this bond; second, the said one-fourth per cent loss of said insured shall also be deducted from said total losses, and the remainder shall be and constitute the amount of indemnity to be paid by the insurer not to exceed $10,000." The insured suffered a loss of over $23,000 on sales to one person. It was held, that the twelve per cent and the one-fourth of one per cent were to be deducted from $7500, and the balance measured the insured's recovery.[1] In another case the policy stated that $3750 was the initial loss to be borne by plaintiff, and that "when claims should be allowed by the insurer beyond the amount to be borne by it, such claims should be at once transferred to the insurer, and the latter should become the owner thereof to the extent of the amount paid thereon, and that the amount realized therefrom, less cost of collection, should be divided *pro rata* as the interests of each might appear." Another clause was as follows:

"To simplify adjustment and to avoid disputes, it is agreed that such sum of gross loss shall be the limit to be borne by the indemnified, as less 25 per cent will equal the agreed amount of net annual loss, all claims making up such sum of gross loss to remain the property of the indemnified, the company relinquishing its claims as hereinbefore provided."

This last clause was regarded as obscure, and the court refused to consider it as an agreement that the claims should be retained by the insured, the latter relinquishing the right thereto on condition that a larger limit of loss than that stated should be borne by the insurer.[2]

1 Rice *v.* Nat. Cr. Ins. Co., 164 Mass. 285; 41 N. E. Rep. 276.

2 Jaeckel *v.* Am. Cr. Indemn. Co., 34 N. Y. App. Div. 565; 54 N. Y. Sup. 505; see also Am. Cr. Indemn. Co. *v.* Wood, 73 Fed. 81; 19 C. C. A. 264.

A policy provided against loss from the insolvency of those to whom the insured should sell goods in excess of five-eighths of 1 per cent of the amount of his total sales. Advances made on goods were protected and covered thereby. All claims for debts due the insured from any one individual were limited to $10,000. The tenth condition of the policy was:

"All settlements accepted, amounts paid, secured or guaranteed, or in process of collection on any claim at the time of final proof of loss, shall first be deducted and pro-rated on shipments made under it before condition number eight shall apply."

That condition provided for additional deductions of 15 per cent of the amount of the claim, and five-eighths of 1 per cent of the amount of the annual sales. It was held, that sums realized after a debtor's insolvency should be deducted in full, and not apportioned between the insured and uninsured part of a debt contracted wholly during the life of the policy, and that insured was entitled to deduct from the price realized on the sale of goods consigned to him his commissions before crediting the amount received on the sale on the indebtedness.[1]

Again, under a clause of the policy declaring that, in estimating the loss of the insured upon a debt due him from an insolvent, "the securities of such debtor held by any one at the time of the appointment of such receiver, taken at their actual value, and the other assets of such debtor taken at the value as shown by his books . . . less 25 per cent, should be deemed a payment to the extent of such value on account of the amount owing to the insured," it was held that neither the lands of the debtor nor mortgages upon them were "securities of such debtor." [2]

A most important question to be considered in this connection is that with reference to the amount to be deducted from all claims presented by the insured, on account of the

[1] Talcott *v.* Nat. Cr. Ins. Co., 28 N. Y. App. Div. 75; 51 N. Y. Sup. 84.

[2] People *v.* Merc. Cr. Guar. Co., 35 N. Y. Misc. 755; 72 N. Y. Sup. 373.

"initial loss," which under the provisions of the policy must first be borne by such insured. Policies of credit insurance as now written usually provide indemnity against loss in a designated amount, over and above an initial gross loss of a stipulated amount, to be first borne by the insured. Some of the policies also provide that all claims making up the initial loss shall remain the property of the insured, and that a first proof of loss shall be made within a certain time after knowledge of the insolvency of the debtor, and another and final proof be filed later within a certain period of time after the expiration of the policy, and that the amount due from the insurer under first proof shall be adjusted and paid within sixty days after receipt of such final proof. Under such provisions as have just been set forth, it would seem that, as the insurer's liability under the policy is referable to the first proof of loss, the initial loss to be borne by the insured is to be ascertained as of the same period, and hence that a debt from an insolvent debtor within the terms of the policy, but paid before the same expired, is not to be treated as a part of such initial loss.[1]

Where a corporation has insured creditors against loss of

[1] In this connection attention is called to the cases of Talcott *v.* Gray as receiver of the U. S. Cr. Sys. Co., 59 N. J. Eq. 595; 42 Atl. 603; Smith *v.* Nat. Cr. Ins. Co., 65 Minn. 283; 68 N. W. 28; 72 Minn. 364; 75 N. W. 596; 78 Minn. 214; 80 N. W. 966; Talcott *v.* Nat. Cr. Ins. Co., 51 N. Y. Sup. 84; 28 N. Y. App. Div. 75; Am. Cr. Indemn. Co. *v.* Wood, *et al.*, 73 Fed. 81; 19 C. C. A. 264; Shakman *v.* Cr. Sys. Co., 92 Wis. 366; 66 N. W. 528; Am. Cr. Indemn. Co. *v.* Champion Coated Paper Co., 103 Fed. 609; 43 C. C. A. 340; Am. Cr. Indemn. Co. *v.* Carrollton Fur. Mfg. Co., 95 Fed. 111; 36 C. C. A. 671; Am. Cr. Indemn. Co. *v.* Athens Woolen Mills, 92 Fed. 581; 34 C. C. A. 161; Strouse *v.* Am. Cr. Indemn. Co., 91 Md. 244; 46 Atl. 328; 47 Atl. 1063; Sloman *v.* Guar. Co., 112 Mich. 258; 70 N. W. 886; Robertson *v.* U. S. Cr. Sys. Co., 57 N. J. L. 12; 29 Atl. 421; Jaeckel *v.* Am. Cr. Indemn. Co., 34 N. Y. App. Div. 565; Hayne *v.* Met. Tr. Co., 67 Minn. 245; 69 N. W. 916; Brewing Co. *v.* Starrs, 5 Ont. 189; Pemberton *v.* Oakes, 4 Russ. 154; Ellicott *v.* Ins. Co., 8 Gill & J. 166; McCallum, *et al.* *v.* Nat. Cr. Ins. Co., *et al.*, 86 N. W. 892; U. S. Sys. Co. *v.* Rosenbaum, 64 N. J. L. 34; 37 Atl. 595; 44 Atl. 696; Claflin *v.* Cr. Sys. Co., 165 Mass. 501; 43 N. E. 293; Lauer *v.* Gray, 55 N. J. Eq. 544.

the debts of their commercial debtors and becomes insolvent during the life of a policy, providing that the loss of the insured is to be adjusted by it only as far as it exceeds a stated percentage of his gross sales, the minimum thereof being fixed at an arbitrary sum for the purposes of computation, this minimum must be adopted as to the amount of the gross sales at the time the insurer became insolvent. It is upon this as a basis that in proceedings to dissolve the corporation, the insured may be allowed to recover such proportion of the total liability as the term of the policy bears to the time which has elapsed after its issue and before the insurer became insolvent.[1]

Where the policy provides that, in calculating losses, no credit that may have been given shall be included therein exceeding a credit of 30 per cent on the lowest capital rating of the debtor in the mercantile agency's book or reports, if the insured gives a larger credit than this, the excess only, and not the entire credit, should be excluded.[2]

In another case the policy covered "excess losses" caused by the failure or insolvency of customers of the insured to whom the latter had made sales on credit, such excess losses to be ascertained by deducting from the actual losses fifteen per cent thereof, and also one per cent of the total year's sales, to be not less than a stipulated amount. The policy also stipulated that the year's sales on which the one per cent was to be computed should not be less than $90,000. During the life of the policy the insured became insolvent. It was held that such insolvency terminated the policy. During the period elapsing before the insolvency of the insurer, the insured's sales aggregated only $75,000. It was said that for the purpose of determining the excess loss, the one per cent was to be computed on this amount and not on the aforesaid $90,000.[3]

[1] People *v.* Merc. Cr. Guar. Co., 35 N. Y. Misc. 755; 72 N. Y. Sup. 373.

[2] Shakman *v.* U. S. Cr. Sys. Co., 92 Wis. 366; 66 N. W. 366.

[3] Smith *v.* Nat. Cr. Indemn. Co., 63 Minn. 283; 68 N. W. 28.

In this same case it was held that the insolvency of the insurer dispenses with the necessity of making formal proof of loss in order to recover. Under such circumstances, it was said, the insured can recover on a *quantum meruit.*

With respect to the method of proving claims against credit insurance companies which have passed into the hands of a receiver, the late case of People *v.* Mercantile Credit Guarantee Company [1] is in point. It was held in that case that where a corporation organized under the laws of the state of New York is dissolved by a final judgment of the Supreme Court of that state during the pendency of an action brought against it in a court of general common-law jurisdiction in the state of Illinois, in which action the corporation had appeared, a judgment rendered in the Illinois action against the corporation after its dissolution and after the attorneys who had appeared for it therein had withdrawn their appearance, and without either service of process upon or appearance by the receiver appointed in the dissolution action, is not binding upon the receiver in the state of New York, and is not evidence as against the receiver of the existence of a debt on the part of the corporation. A statute of the state of Illinois authorizing the entry of a judgment against a corporation under such circumstances has no extraterritorial effect. As incidental to the subject now under consideration it may be said that an action against the insurer to recover back premiums paid upon the policy, which had been, subsequent to the issuance thereof, cancelled and rendered ineffective by the acts of the insurer, is not an action upon the policy and the special limitation for bringing suit thereon does not apply.[2]

[1] 65 N. Y. App. Div. 306.
[2] McCallum *v.* Nat. Cr. Ins. Co., *et al.,* Minn. ; 86 N. W. 892.

CHAPTER XVIII

TITLE INSURANCE

§ 235. **Title Insurance defined and discussed.** — Title insurance is an agreement whereby the insurer, for a valuable consideration, agrees to indemnify the insured in a specified amount against loss through defects of title to real estate wherein the latter has an interest either as purchaser or otherwise. The foregoing definition was adopted by the Supreme Court of Pennsylvania in Foehrenbach *v.* German American Title and Trust Company.[1] A contract of the nature just defined has been judicially declared to be one of insurance.[2] To create liability on the part of the insurer there must be privity of contract between it and the party who seeks to compel the latter to make indemnity on account of defects in the title of property whereupon a policy has been issued. This is accomplished so as to give a right of action to purchasers from the insured by inserting the words "and his assigns" after the name of the insured in the policy.

§ 236. **Nature of the Liability of the Insurer under the Policy.** — It was contended in Trenton Potteries Company *v.* Title Guaranty and Trust Company[3] that the obligation of a title insurance company in examining and certifying as to the condition of a title is the same as that of any lawyer who is required to bring to the performance of such duty only the exercise of ordinary reasonable skill and knowledge of his profession. In other words, that liability could be predicated only

[1] 217 Pa. St. 331; 66 Atl. 561.

[2] Trenton Potteries Co. *v.* Tit. Guar. & Tr. Co., 64 N. Y. Sup. 116; 50 App. Div. 490; 176 N. Y. 65; N. E. M. T. Ins. & Tr. Co. *v.* Drexel, 70 Fed. 194; 17 C. C. A. 56; Gauler *v.* Tr. Co., 9 Pa. Co. Ct. Rep. 634; Wheeler *v.* Real Es. Tit. Ins. & Tr. Co., 160 Pa. St. 408; 28 Atl. 849; *Ex parte* Calhoun, 87 Ga. 359; Graham *v.* Law. Tit. Ins. Co., 20 N. Y. App. Div. 440; 46 N. Y. Sup. 1055; Foehrenbach *v.* Ger. Am. Tit. & Tr. Co., 217 Pa. St. 331; 66 Atl. 561.

[3] 64 N. Y. Sup. 116; 50 N. Y. App. Div. 490.

upon negligence and misconduct in the examination.[1] This contention, made in behalf of the insurer, was denied by the court in the following language:

"The contract of insurance is an entirely different contract, wherein the doctrine of skill or negligence has no application. The contract issued by this defendant is one of insurance pure and simple, issued by a corporation for which provision is made in the insurance law of the state. Therein these corporations are placed upon substantially the same footing and are made subject to the same rules as apply to other insurance companies, excepting so far only as the character of the business transacted by the corporation is different from that transacted by other insurance companies recognized and provided for in the same law. . . . That such is the character of these contracts is recognized by decisions in other states."[2]

The United States circuit court of appeals for the eighth circuit remarked with reference to the character of the insurer's liability in title insurance as follows:[3]

"The insurer is not a surety. It agreed for an adequate consideration to 'indemnify, keep harmless and insure' the insured from all loss or damage not exceeding $55,000, the amount of the mortgage debt, which he or his assigns might sustain by reason of defects in the title to the mortgaged premises or by reason of liens or encumbrances thereon existing at the date of the policy. The contract is plain and explicit on this point. In a word, it is a guaranty that the mortgagee (the insured) should not suffer any loss or damage by reason of defects in the title to the property, or liens or encumbrances thereon existing at the date of the policy."

Where a title insurance company merely assumes to act as an abstractor, its duty in such a case is simply to exercise due care.[4] So far as its employment under such circumstances involves a search of the title to the premises and an examina-

[1] See Ehmer *v.* Tit. Guar. & Tr. Co., 156 N. Y. 10; 50 N. E. 420; Banes *v.* N. J. Fid. Guar. & Tr. Co., 142 Fed. 957.

[2] See Wheeler *v.* Tr. Co., 160 Pa. St. 408; 28 Atl. 849.

[3] Minn. Tit. Ins. & Tr. Co. *v.* Drexel, 70 Fed. 194; 17 C. C. A. 56.

[4] Economy Bldg. & Loan Ass. *v.* W. J. Tit. & Guar. Co., 64 N. J. L. 27; 44 Atl. 854; see also Ehmer *v.* Tit. Guar. & Tr. Co., 156 N. Y. 10; 50 N. E. 420; Trenton Potteries Co. *v.* Tit. Guar. & Tr. Co., 61 N. Y. Sup. 118; 50 N. Y. App. Div. 490.

tion of the same, its duty would not be other or different than that of a lawyer engaged to perform the same service, the obligations in such case being the exercise of ordinary reasonable skill and knowledge of the profession, and liability could only be predicated of negligence and misconduct in the examination.[1]

§ 237. **Construction of Policies.** — Contracts of title insurance are subject to the same rules as are applicable to other insurance policies, and all doubts and ambiguities, if any, contained in the policy are to be resolved in favor of the insured.[2]

§ 238. **The Application.** — It is customary to require parties applying for title insurance to fill out printed applications for the same, wherein are to be found a number of questions relative to the proposed insurance. It is usually the practice to refer to this application by number in the policy and to therein provide that the facts stated in the application shall constitute warranties.[3]

§ 239. **Scope of Liability.** — The determination of the scope of liability in title insurance is ordinarily of no great difficulty. The terms used in defining such scope are nearly always well understood and have been frequently construed by the courts.[4] The liability usually extends to defects in the chain of title, encumbrances, judgments, mechanics' liens, assessments, etc.[5] Within the ordinary scope of liability are defects in the title to the premises at the time the policy is

[1] Place *v.* St. P. Tit. Ins. & Tr. Co., 67 Minn. 126; 69 N. W. 706.

[2] Trenton Potteries Co. *v.* Tit. Guar. & Tr. Co., 64 N. Y. Sup. 116; 58 N. Y. App. Div. 490; Tr. Co. *v.* Drexel, 70 Fed. 194; 17 C. C. A. 56; Place *v.* St. P. Tit. Ins. & Tr. Co., 67 Minn. 126; 69 N. W. 706.

[3] See Stensgard *v.* St. P. Real Es. Tit. Ins. Co., 50 Minn. 429; 52 N. W. 910.

[4] See Quigley, *et al.* *v.* St. P. Tit. Ins. & Tr. Co., 60 Minn. 275; 62 N. W. 287; 64 Minn. 149; 66 N. W. 364; Ger. Am. Tit. & Tr. Co. *v.* Cit. Tr. Sur. Co., 190 Pa. St. 247; 42 Atl. 682; Wheeler *v.* Real Es. Tit. & Tr. Co., 160 Pa. St. 408; 28 Atl. Rep. 849; Trenton Potteries Co. *v.* Tit. Guar. & Tr. Co., 64 N. Y. Sup. 116; 50 N. Y. App. Div. 490.

[5] Minn. Tit. Ins. & Tr. Co. *v.* Drexel, *et al.*, 70 Fed. 194; 17 C. C. A. 56.

issued; liens or encumbrances affecting the same at said time; and finally, any defect apparent of record in the execution or filing for record of the instrument of conveyance in connection with which the policy is issued.[1] The general intent and effect of policies of title insurance is to insure a valid security both as to title and against encumbrances. There is no implied agreement to go beyond the conditions existing at the time the policy is issued and to assume a general liability to indemnify against future encumbrances, municipal or otherwise.[2] The words of the Pennsylvania Supreme Court in Foehrenbach *v.* German American Title and Trust Company [3] are instructive in this connection:

"Loss is a relative term. Failure to keep that which one has is loss. The plaintiff in this case, upon September 12, 1894, found himself in possession of a property devised to him, as he supposed and claimed, in the will of his mother. Wishing to safeguard himself in the enjoyment of his title, he applied to the defendant company for insurance. 'Title insurance is an agreement whereby the insurer, for a valuable consideration, agrees to indemnify the insured in a specified amount against loss through defects of title to real estate wherein the latter has an interest either as purchaser or otherwise.' [4] It must be borne in mind that the real subject of insurance is not the concrete thing, but the interest which the one to be indemnified has in the concrete thing. The interest which the plaintiff desired to protect was the entire interest as the owner in fee of the property in question. It was this interest which he submitted to defendant company as the subject-matter of insurance. It was for the company then to examine the evidence of his title, and see whether or not it would assume the risk of making good to him the injury which would result in case his claim of title to the entire interest should prove defective. The contract which he asked for and which by this policy the company made with him, was one of insurance against defects in the title as he claimed it to be, and as the company agreed with him after examination that it was, viz. title to the entire interest in the property. The policy applied to the situation as it then existed. It insured the plaintiff against defects, unmarketability, liens and encumbrances as of that

[1] Quigley *v.* St. P. Tit. Ins. & Tr. Co., 60 Minn. 275; 62 N. W. 287.

[2] Barton *v.* W. J. Tit. & Guar. Co., 64 N. J. L. 24; 44 Atl. 871.

[3] 217 Pa. St. 331; 66 Atl. 561.

[4] Frost on Guar. Ins. § 162.

date. It said to him: 'You are, in our judgment, the owner in fee of the entire interest in this property, and we will back our opinion by agreeing to hold you harmless up to the amount of the policy, in case, for any reason, our judgment in this respect should prove to be mistaken.'

"The risks of title insurance end where the risks of other kinds of insurance begin. Title insurance is designed to protect the insured and save him harmless from any loss arising through defects, liens or encumbrances that may be in existence, affecting the title when the policy is issued. It does not protect him against any claim arising after the issuance of the policy."

The liability under the policy has been extended to the case where an adjoining wall is used by the party owning the land next adjacent to the property, the title of which was insured, who refuses to pay for such use.[1] In Trenton Potteries Company *v.* Title Guaranty and Trust Company,[2] it was held, that where a policy of title insurance is procured by the grantee of real property after he has taken possession thereof, under his deed, whereby the grantee is insured against defects of title arising by reason of liens of encumbrances on the property at the date of the policy, and contains a provision that the liens and encumbrances arising after the date of the policy or created or suffered by the insured, and assessments not confirmed at the date of this policy, are not to be deemed covered by it, liability thereunder extends to a confirmed reassessment existing at the date of the policy, although the confirmation took place after the grantee had taken possession under his deed. This ruling was expressly based upon the principle that the policy was to be construed as covering encumbrances existing at its date, when the insured took his deed and entered into possession of the property. In an action upon a policy of title insurance, grounded on the eviction of the insured from the land, it is necessary that the declaration show either an eviction or a disturbance of title or possession under a paramount title equivalent to an evic-

[1] Thomas *v.* Tradesmen's Tr. & Sav. Funds Co., 7 Pa. Dist. Ct. Rep. 375.

[2] 50 N. Y. App. Div. 490; 61 N. Y. Sup. 118.

tion.[1] Where a policy of title insurance excepted the tenure of the present occupants of the land, the title to which was secured, and also excepted encumbrances not shown by any public record, then under such a policy the insurer merely guarantees the record title.[2] Where the insurer undertakes to defend the insured, it is bound to protect him through all stages of the proceeding, or else notify him that it will not, in time to enable him to protect himself. It is also bound at all times to furnish him all reasonable information as to the status of adverse claims, so as to enable him to take all proper precautions for his protection.[3]

So, too, it has been held that a title insurance policy covers a loss resulting from a misdescription of the premises in the insured conveyance, although the error was not the fault of the insurer.[4]

A policy was issued insuring against all loss by reason of defects or unmarketableness of the title to the estate or mortgage interest insured or because of liens or encumbrances charging the same at the date of the policy, saving defects or objections to title by reason of liens, charges and encumbrances thereon, which do or may now exist, including unmarketability, by reason of the possibility of mechanics' and municipal liens, but not actual losses by reason of such liens. It was held that the insurer was not liable for municipal claims filed against the property three years after the policy issued. The insurance only applies against liens the rights to which are already inchoate at the date of the policy.[5]

A leading case on the scope of liability in title insurance is that of Minnesota Title Insurance and Trust Company *v.* Drexel.[6] The policy here issued by the insurer was condi-

[1] Barton *v.* W. J. Tit. & Guar. Co., 64 N. J. L. 24; 44 Atl. 871.

[2] Bothin *v.* Cal. Tit. Ins. & Tr. Co., Cal. ; 96 Pac. 500.

[3] Quigley *v.* St. P. Tit. Ins. & Tr. Co., 64 Minn. 149; 66 N. W. 364.

[4] Gauler *v.* Solicitors' Loan & Tr. Co., 9 Pa. Co. Ct. 634.

[5] Wheeler *v.* Real Es. Tit. & Tr. Co., 160 Pa. St. 408; 28 Atl. Rep. 849.

[6] 70 Fed. 194; 17 C. C. A. 56.

tioned against loss sustained through defects in the title to real estate insured, or liens or encumbrances thereon existing at the date of the policy. It was further provided that no right of action upon the policy should accrue until the insured had conveyed or agreed to convey to the insurer his interest in the property at a price which in the case of a title acquired through a foreclosure should be the amount bid at the foreclosure sale; that payment, discharge or satisfaction of the mortgage indebtedness, except by foreclosure of the mortgage, should annul the policy; and that the insurer should have an opportunity to defend any suits affecting the title. After the issue of the policy, suits were brought to establish mechanics' liens on the property claimed to have existed when the policy was issued. The insurer defended them, but the liens were established and the property sold to satisfy them. The insured foreclosed his mortgage and brought it in for the amount due on said mortgage with interest and costs. Later, the insured offered to convey title to the insurer for the amount bid at the foreclosure sale, and demanded, in default of a purchaser for that amount, that the insurer redeem the property from the sale had under the mechanics' lien judgments. The insurer declined to do either, and the insured redeemed the property, and thereupon sued the insurer for the amount so paid. In passing upon the legal questions therein involved, the federal court of appeals for the eighth circuit spoke as follows:

"Under the policy, if the mortgaged property, with a clear title and free from encumbrances, was worth the amount of the mortgage debt, the mortgagee could confidently rely upon the sufficiency of his security. The mechanics' liens upon which the mortgaged property was sold were the liens upon the property at the date of the policy. The insurer nevertheless refused either to pay these prior liens or to pay the insured the amount bid for the property at the foreclosure sale, which was the amount of his mortgage debt, thus forcing the insured, in order to protect his security and his title, to redeem the property from the sale on the mechanics' liens. The policy provides that where by foreclosure the insured has acquired

title to the property, the price to be paid by the insurer shall be the amount bid at said foreclosure sale. The insurer was obligated by the terms of the policy either to pay this amount or to relieve the property from all liens existing thereon at the date of the policy. It refuses to do either, and seeks to escape all liability by putting the burden of freeing the property from the liens existing thereon at the date of the policy upon the mortgagee, on the ground that, at the sale of the property under the mortgage debt, the mortgagee bid the full amount of his mortgage debt, and thereby himself assumed the burden of paying off the mechanics' liens. Under the terms of the policy, the mortgagee had the right to look to the insurer for the extinguishment of all liens upon the property which existed at the date of the policy and to gauge his bid on the assumption that the insurer would discharge its obligation in this regard. The contention of the insurer is in the teeth of a very plain provision of the policy, which declares that payment, discharge or satisfaction of said mortgage indebtedness shall fully terminate, annul and avoid the policy and all liability of the insurer thereunder. The case at bar falls directly within this exception. We need not consider what effect this provision would have where the property was purchased by a stranger at the foreclosure sale. Beyond controversy it includes and binds the parties to the contract, and is applicable to every case where the mortgagee insured becomes the purchaser of the property at the foreclosure sale for the amount of his mortgage debt."[1]

§ 240. **Representations, Warranties and Conditions in Title Insurance.** — The doctrines of general insurance law with reference to misrepresentation, breach of warranty and breach of conditions appear to have full application to title insurance.

In Stensgard *v.* St. Paul Real Estate Title Insurance Com-

[1] See generally as to scope of liability in title insurance the following cases: Banes *v.* N. J. Tit. Guar. & Tr. Co., 142 Fed. 957; Renkert *v.* Tit. Guar. & Tr. Co., (Mo. Ct. of App.) ; 76 S. W. 641; Ocean View Land Co. *v.* W. J. Tit. Guar. Co., 71 N. J. L. 600; 61 Atl. 83; Thomas *v.* Tradesmen's Tr. & Sav. Funds Co., 7 D. R. 375; (1898) s. c., 21 Pa. C. C. 151; Dover *v.* Commonwealth Tit. Ins. & Tr. Co., 6 D. R. 263; (1897) Foehrenbach *v.* Ger. Am. Tit. & Tr. Co., 217 Pa. 331; Trenton Potteries Co. *v.* Tit. Guar. & Tr. Co., 176 N. Y. 65; 14 Bedell 126; Taylor *v.* N. J. Tit. & Guar. Co., 70 N. J. L. 24; Burton *v.* W. J. Tit. Co., 64 N. J. L. 24; Whiteman *v.* Merion Tit. & Tr. Co., 25 Pa. Sup. Ct. 320; Hankey *v.* Real Es. Tit. Co., 1 D. R. 65; (1891) s. c., 11 Pa. C. C. 320; Bothin *v.* Cal. Tit. Ins. & Tr. Co., Cal. ; 96 Pac. 500.

pany[1] it was held that where a policy of insurance provides that any untrue answers to questions contained in the application should avoid the policy, the answers amount in legal effect to a warranty, and the matter of their materiality is not open. "The effect of falsity in the statement on the validity of the contract is not made to depend on the intent with which the statement is made, as that the intent shall be fraudulent, but on whether true or false to the best of the applicant's knowledge and belief. Where the contract itself does not stipulate the effect that a particular false statement or representation shall have on the contract, or where it stipulates merely that the misrepresentation or suppression of a material fact shall avoid it, the fact misrepresented or suppressed must have been material, as an inducement to enter into the contract; and as the materiality must be shown by matters outside the terms of the contract, it is a question of fact. But the parties may by their contract determine the materiality for themselves, as where they stipulate that if a statement of fact made by one of them and set forth in the contract be false, it shall avoid the contract. In such a case the statement is in effect a warranty. Whether they have made the statement material and in effect a warranty is a question for the court, to be determined by an interpretation of the contract."[2] In the case from which the foregoing quotation was made, the insured, in answer to a question contained in the application, stated that the last price paid for the property, the title to which was to be insured, was $11,000. This statement the insurer claimed was false and that its legal effect was to avoid the policy. In sustaining this contention the court held that the question called for the actual, not merely the nominal, price, and inasmuch as it appeared that, although the consideration stated in the deed was $11,000, the transaction was really a trade of mining stock of little value and $3,000 in cash, and that an instruction to

[1] 50 Minn, 429; 52 N. W. 910.

[2] Stensgard *v.* St. P. Real Es. Tit. Ins. Co., 50 Minn. 433; 52 N. W. 910.

the jury that if $3,000 and the market value of the stock amounted to $11,000, or that the insured honestly believed he was paying $11,000 cash value and the grantor accepted it as that amount in money, they should find the answer true, was sufficiently favorable to the insured under the circumstances. Again, in another case, a policy had been issued insuring the mortgagor's title for the mortgagee's benefit, providing that no right of action should accrue under it unless the insured was actually evicted under an adverse title, or unless there had been a final judgment upon a lien or encumbrance under which the title of the insured should be divested by sale under judgment or foreclosure, or unless the insured had contracted to sell the estate or interest insured and the title had been declared by a court of last resort of competent jurisdiction defective or encumbered by reason of a defect or encumbrance for which insurer would be liable. Notwithstanding these conditions of the policy, they were held not to apply where the land was held under actual adverse possession, and plaintiff had lost it absolutely by reason of a defect in the title insured.[1]

In a Minnesota case it was agreed in an application that the statements therein contained were correct and true to the best of the applicant's knowledge and belief, and that any false statements or any suppression of material information should avoid the policy applied for. In answer to a question therein contained, the insured stated that there were no liens or encumbrances on the insured's property, except a certain mortgage. To the further question, "Are any of said encumbrances to remain?" the applicant answered, "Only the $2200 mortgage now insured." At the time the application was made, no part of the labor or material for which certain mechanics' liens were afterwards filed had been furnished, but other labor and material had been furnished in doing other parts of the work, and of the amount to be paid for the same, $1700 was unpaid. It was contended that the

[1] Place *v.* St. P. Tit. Ins. & Tr. Co., 67 Minn. 126; 69 N. W. 706.

amount due on these unpaid claims constituted mechanics' liens on the title; that the application warranted the truth of the statements above referred to, and that they were false and consequently avoided the policy, even though no loss or prejudice resulted by reason thereof. The court refused to sustain this contention, and in doing so based its action upon the principle that where a policy contains a condition which renders it void at its inception, and this is known to the insurer when it issues the policy, the latter thereby waives the condition.[1]

"Tenancy of the present occupants," stated in a title insurance policy as a defect to the title against which the insurer does not insure, means tenancy which arises through the occupation or temporary possession of the premises by those who are tenants in the popular sense. It does not include those who are asserting ownership in fee as against the title insured, and who are in adverse possession at the time the policy is issued. The complaint did not allege compliance with the conditions as to a contract to sell or that the title had been declared defective by a court of last resort. It was held that, under the circumstances, these conditions were ineffective and void. They apply only to guard against actions for nominal damages instituted by persons who had ascertained that defects existed in their titles, but whose possession remained undisturbed and who had suffered no loss.[2]

Such conditions do not apply to a case where not only does another party hold possession of the land adversely to the insured, but the latter has lost it absolutely by reason of a defect in the insured's title.[3]

[1] Quigley *v.* St. P. Tit. Ins. & Tr. Co., 60 Minn. 275; 62 N. W. 287.

[2] Place *v.* St. P. Tit. Ins. & Tr. Co., 67 Minn. 126; 69 N. W. 706.

[3] *Idem.* See generally as to subject-matter of representations, warranties and conditions the following cases: Banes *v.* N. J. Tit. Guar. & Tr. Co., 142 Fed. 957; Renkert *v.* Tit. Guar. & Tr. Co., Mo. Ct. of App. ; 76 S. W. 641; Ocean View Land Co. *v.* W. J. Tit. Guar. Co., 71 N. J. L. 600; 61 Atl. 83; Thomas *v.*

§ 241. **The Measure of the Insured's Damage.** — In title insurance actual loss must precede actual compensation.[1] Where the policy runs direct to the purchaser of the property and the title turns out to be wholly defective, the measure of damages is the price paid for such property.[2]

In another case, where a mortgagee's policy had been issued and the property sold under foreclosure of mechanics' liens covered by the policy, — the insured meanwhile having foreclosed his mortgage and bid the property in at the sale, — it was held that the purchase of the property by the insured at the foreclosure sale did not extinguish the insurable interest of the insured under the conditions of the policy and thus annul the latter, but that the insurer was bound either to buy the property for the amount bid at the mortgage foreclosure sale, or else redeem it from the sale had under the mechanics' liens, and that the insured was entitled to recover the amount paid by it for this last purpose.[3]

Where by reference to a contract in the policy it becomes a part of it, and the insurer limits its liability under the policy to $2200 by reason of defects in the insured's title, but fur-

Tradesmen's Tr. & Sav. Funds Co., 7 D. R. 375; (1898) s. c., 21 P. C. C. 151; Dover *v.* Commonwealth Tit. Ins. & Tr. Co., 6 D. R. 263; (1897) Foehrenbach *v.* Ger. Am. Tit. & Tr. Co., 217 Pa. 331; Trenton Potteries Co. *v.* Tit. Guar. & Tr. Co., 176 N. Y. 65; 14 Bedell 126; Taylor *v.* N. J. Tit. & Guar. Co., 70 N. J. L. 24; Burton *v.* W. J. Tit. Co., 64 N. J. L. 24; Whiteman *v.* Merion Tit. & Tr. Co., 25 Pa. Sup. Ct. 320; Hankey *v.* Real Es. Tit. Co., 1 D. R. 65; (1891) s. c., 11 Pa. C. C. 320; Bothin *v.* Cal. Tit. Ins. & Tr. Co., Cal. ; 96 Pac. 500.

[1] *Idem.*

[2] Ehmer *v.* Tit. Guar. & Tr. Co., 156 N. Y. 10; 50 N. E. 420; see also Ger. Am. Tit. & Tr. Co. *v.* Cit. Tr. & Sur. Co., 190 Pa. St. 247; Quigley *v.* St. P. Tit. Ins. & Tr. Co., 64 Minn. 149; St. P. Tit. Ins. & Tr. Co. *v.* Johnson, 64 Minn. 492; 67 N. W. 543.

[3] Minn. Tit. Ins. & Tr. Co. *v.* Drexel, *et al.*, 70 Fed. 194; 17 C. C. A. 56; Ger. Am. Tit. & Tr. Co. *v.* Cit. Tr. & Sur. Co., 190 Pa. St. 247; 42 Atl. 682. See generally on the subject of title insurance: St. P. Tit. Ins. & Tr. Co. *v.* Johnson, *et al.*, 64 Minn. 492; 67 N. W. 543; Tit. Guar. & Tr. Co. *v.* Wrenn, 36 Ore. 62; 56 Pac. 271; Russ *v.* Law. Tit. Ins. Co., *et al.*, 8 N. Y. Misc. Rep. 6; 28 N. Y. Sup. 392; Fid. Ins. Tr. & Safe Dep. Co. *v.* Earle, *et al.*, 23 Pa. Co. Ct. Rep. 449; Barton *v.* W. J. Tit. & Guar. Co., 64 N. J. L. 24; 44 Atl. 871.

ther agrees by said contract to defend the same or pay the claim on which suit is brought, or pay the insured the amount of the liability under the policy, and in undertaking a defence is guilty of negligence therein, even if under no legal liability to defend a claim not covered by the policy, the amount of the recovery is not limited to the $2200 named as the limit of liability under the policy.[1]

[1] Quigley *v.* St. P. Tit. Ins. & Tr. Co., 60 Minn. 275; 62 N. W. 287; see also same case, 64 Minn. 149; 66 N. W. 364. See generally on the subject of the measure of the insured's damages in title insurance policies the following cases: Banes *v.* N. J. Tit. Guar. & Tr. Co., 142 Fed. 957; Renkert *v.* Tit. Guar. & Tr. Co., Mo. Ct. of App. ; 76 S. W. 641; Ocean View Land Co. *v.* W. J. Tit. Guar. Co., 71 N. J. L. 600; 61 Atl. 83; Thomas *v.* Tradesmen's Tr. & Sav. Funds Co., 7 D. R. 375; (1898) s. c., 21 Pa. C. C. 151; Dover *v.* Commonwealth Tit. Ins. & Tr. Co., 6 D. R. 263; (1897) Foehrenbach *v.* Ger. Am. Tit. & Tr. Co., 217 Pa. 331; Trenton Potteries Co. *v.* Tit. Guar. & Tr. Co., 176 N. Y. 65; 14 Bedell 126; Taylor *v.* N. J. Tit. & Guar. Co., 70 N. J. L. 24; Burton *v.* W. J. Tit. Co., 64 N. J. L. 24; Whiteman *v.* Merion Tit. & Tr. Co., 25 Pa. Sup. Ct. 320; Hankey *v.* Real Es. Tit. Co., 1 D. R. 65; (1891) s. c., 11 Pa. C. C. 320.

PART V. JUDICIAL INSURANCE

CHAPTER XIX

JUDICIAL INSURANCE

§ 242. **Judicial Insurance defined and classified.** — Judicial insurance is an agreement whereby for an agreed premium one party (termed the insurer) agrees to indemnify another (termed the insured) in a designated amount against loss arising either through the official misconduct of a third party, known as the "risk," in his capacity as an appointee of a court, or else through the failure of such "risk" to faithfully perform the conditions of his formal undertaking entered into while a litigant before the courts. There are two classes of bonds which properly come within the category of judicial insurance contracts. The first embraces what may be termed "administration bonds," such, for example, as are furnished by executors, administrators, guardians, conservators, committees of lunatics, curators, trustees, assignees, receivers, masters, etc. In the second class are found that large class of bonds required by statute to be given either in the course of litigation or such as are subject to control by the courts. These bonds may be termed "statutory," and as examples thereof may be mentioned appeal, arrest, attachment, capias, sheriff's indemnity, maritime libel, replevin, injunction, ne exeat, arbitration, bail, detinue, partition, supersedeas, certiorari, bastardy, peace, support, stay and removal bonds.

Partly for purposes of convenience and partly owing to their quasi-judicial nature, the subject-matter of "excise bonds" and other bonds furnished pursuant to statute (other

than official or contract bonds) will be considered herein under the head of "statutory bonds."

§ 243. **The Nature of Judicial Insurance Bonds.** — At the very threshold of the present discussion one is confronted with the question as to whether judicial bonds of the kind executed by the so-called "surety companies" for compensation can be properly termed contracts of insurance. As in fidelity and commercial insurances, where similar questions were considered, the answer must be unhesitatingly in the affirmative.[1] This matter came directly before the court for determination in Industrial and General Trust *v.* Tod,[2] where a statute of the state of New York limiting the amount of any one risk which may be assumed by "insurance companies" to 10 per cent of its capital and surplus was held applicable to "surety companies" guaranteeing the performance of contracts and executing bonds and undertakings required in or permitted in all actions or proceedings or by law allowed.[3]

These insurance bonds, given in the course of legal proceedings, are to be considered as something more than mere contracts between the parties. They are part and parcel of the judicial proceedings themselves.[4]

Both administration and statutory insurance bonds are contracts, not only between the parties interested in the proceedings wherein they are given, but they constitute as well a contract with the state touching the due administration of justice to the effect that all the requirements of law and of the court shall be observed and that the privileges afforded

[1] See Phila., Harrisburg & Pittsburg R. R. Co. *v.* Gorgas Es., 14 Pa. Dist. Ct. 824; Emery *v.* Pa. Monongahela & Sou. Ry. Co., 15 Pa. Dist. 749; Am. Bank. & Tr. Co., 4 D. E. 757; (1895) 17 Pa. C. C. 274; 37 W. N. C. 293; 43 Pittsburg L. J. 213.

[2] 56 N. Y. App. Div. 39; 67 N. Y. Sup. 362.

[3] See in this connection, People *ex rel.* Nat. Sur. Co. *v.* Feitner, *et al.*, 31 N. Y. Misc. Rep. 433; 54 N. Y. App. Div. 633; 166 N. Y. 129; 59 N. E. 731; Epstein *v.* U. S. Fid. & Guar. Co., 29 N. Y. Misc. 295; 60 N. Y. Sup. 527; Joy *v.* Eton, 83 N. Y. 875; Matter of Thurber, 43 N. Y. App. Div. 528; 166 N. Y. 244; 56 N. E. 631.

[4] People *ex rel.* Ritzenthaler *v.* Higgins, 151 N. Y. 570; 45 N. E. 1033.

thereby in consideration of the acceptance thereof by the courts shall not be abused.[1]

§ 244. **Construction of Judicial Insurance Bonds.** — Judicial insurance — in respect to matters of construction — presents some strong points of differentiation from its sister branches, fidelity and commercial insurances. Particularly is this noticeable in the absence of any substantial recognition in judicial insurance of that principle of fidelity insurance law which requires — in case of uncertainty as to the meaning of the language of the policy — that it shall in all cases be construed most strongly against the insurer.[2]

Indeed, no one who gives a careful reading of the decisions relating to judicial insurance bonds can fail to recognize the fact that, with some few exceptions, they have been treated by the courts as if in all respects identical in legal effect with the undertaking of the private surety, so familiar in the domain of suretyship. Why this should be is perhaps attributable to the fact that the statutes under which such bonds are given provide that they shall be executed by "sureties," which term is usually, by special statute, made applicable to incorporated companies engaged in the business of furnishing such bonds for compensation. Perhaps it results from a combination of causes, among which are the following: the form of the contract itself, being almost invariably prescribed by statute, or sanctioned by long judicial usage, is essentially the same, whether the instrument be the undertaking of the private surety or the more formal bond of the "corporate surety company." Again, the contracts themselves, while as a matter of practice drawn by the insurer, admit of little

[1] See Lyman *v.* Schermerhorn & Fid. & Dep. Co., 53 N. Y. App. Div. 32; 167 N. Y. 113; 60 N. E. 324; People *ex rel.* Ritzenthaler *v.* Higgins, 151 N. Y. 570; 45 N. E. 1033; State *ex rel.* Board of Liquidation *v.* Briede, 117 La. 183; 41 Sou. 487; Mullins, etc. *v.* Fidelity & Deposit Company, 30 Ky. L. Rep. 1077; 100 S. W. 256.

[2] See, however, Doon *v.* Am. Sur. Co., 110 App. Div. 215; 97 N. Y. Sup. 270; Hurley *v.* Fid. & Dep. Co., 95 Mo. App. 88; 68 S. W. 958; Sacks *v.* Am. Sur. Co., 72 N. Y. App. Div. 60; 76 N. Y. Sup. 335.

choice, either in language or terms, because these are almost invariably prescribed by statute or immemorial usage. Therefore the reason for the rule that governs in fidelity insurance relative to matters of construction does not exist to the fullest extent in judicial insurance.

Finally, there is an almost entire absence of the usual concomitants of insurance contracts, such as proposals, applications, representations, warranties and multiform conditions, which in themselves suggest, if they do not almost compel the courts to treat such agreements as contracts of insurance rather than those of suretyship. However, here, as in other forms of guaranty insurance, the contract being entered into for a consideration and not gratuitous, this marked disposition of the courts to apply to judicial insurance bonds the rules of private suretyship rather than the principles of insurance law cannot well be reconciled on grounds of judicial consistency. The present prevailing doctrine of the courts with respect to the status of "surety companies" issuing such bonds is well set forth by the Maryland court of appeals in March *v.* Fidelity and Deposit Company of Maryland.[1] In that case the court said:

"When the statute enabled this corporation to become a surety, it described a relation perfectly well known and understood in law. Certain rights, duties, responsibilities and functions belong to the condition of suretyship, and they are all necessarily and conclusively implied when one lawfully becomes a surety. These incidents must attach to the suretyship in this case (administrator's bond) unless the statute which authorized it establishes and defines a difference between it and the contracts of ordinary suretyship."[2]

Another statement of the rule is this:

"The contract of the surety is to be construed like other contracts, so as to give effect to the intention of the parties. In ascertaining that intention we are to read the language used by the parties in the light of the circumstances surrounding the execution of the instru-

[1] 79 Md. 309; 29 Atl. 521.

[2] See also Feinburg *v.* Am. Sur. Co., 33 N. Y. Misc. Rep. 458; Con. Tr. Co. *v.* Columbia Finance & Tr. Company, Ky. ; 60 S. W. 1.

ment, and when we have thus ascertained their meaning we are to give it effect. But when the meaning of the language used has been thus ascertained, the responsibility of the surety is not to be extended or enlarged by implication or construction, and is *strictissimi juris*."[1]

In Lyman *v*. City Trust, Safe Deposit and Surety Company of Philadelphia, *et al.*,[2] the question as to what rule of construction should apply to judicial insurance bonds was before the New York court of appeals for determination. It was contended strenuously in that case by counsel for the "surety company" that its liability was not to be extended beyond the strictest terms of the bond. In disposing of this contention adversely, the court used these words:

"The rule of law invoked by the 'surety company' depends for its application upon the ascertainment of the intention of the parties to the instrument, which is to be reached upon a consideration of the whole thereof, in the light of the circumstances under which it was made."

Indeed, evidence is not wanting of a tendency on the part of the courts to apply to the contract of the compensated surety different rules of construction from those applied in the case of private sureties. Thus, in the Matter of Thurber,[3] the appellate division of the New York Supreme Court had occasion to consider an application on the part of a "surety company" to be released from its liability under an administration bond, based on certain provisions of the New York Code, which it was claimed were only applicable to private sureties. In passing upon the application the court said:

"It is fair to assume that when acts were first passed authorizing the release of sureties upon their application, it was in view of the fact that such sureties were, for the most part, so engaged without consideration, and acted gratuitously. Under such circumstances there was a strong equity existing in their behalf, which made the provision for their relief entirely proper. . . . By statute, persons

[1] Thompson *v.* Am. Sur. Co., 56 N. Y. App. Div. 113; 67 N. Y. Sup. 564; 170 N. Y. 111.

[2] 166 N. Y. 274; 59 N. E. 903.

[3] 43 N. Y. App. Div. 528; see same case, 162 N. Y. 244; 56 N. E. 631.

required to give bonds under the provisions of any law are authorized to give the bond or undertaking of any fidelity or insurance company authorized by the laws of the state to transact business. . . . By the provisions of such statutes, the 'surety or sureties, or the representatives of any surety or sureties upon the bond' may be discharged, upon complying with its provisions. The only mention of a fidelity or surety company in terms in the statute is found in the beginning thereof, and relates to the form of the bond of surety when so given. If the right is reserved to it to be discharged from liability, it must be found in the general term 'surety or sureties.' These words are apt in embracing the former class of persons who were sureties without consideration. Of course they are broad enough in their terms to embrace a surety company; but wherever the statute refers to such company, it is named in terms, and we think that before it can invoke an authority so extraordinary as to relieve it from a contract founded upon a valuable consideration, and of which there has been no breach or claim of breach, it should be required to point to specific words showing that it was the intent of the legislature to embrace such case. The construction of this statute will be satisfied, giving full force to all its words, by holding that the surety company, not having been named in specific terms therein, was not intended to be embraced. . . .

"We think that where the surety company engages for a consideration to become a surety, it ought not to be relieved from such contract except there be a breach of the same by the person with whom it contracts."

When this same case was heard later by the New York court of appeals, the latter, while refusing to adopt the general line of reasoning of the lower court, nevertheless observed that no rule of law required that the agreement should receive a narrow or strict construction. Its meaning must be ascertained from the language therein contained, and having arrived at that from a consideration of the whole instrument, effect must be given to the intention of the parties as thus ascertained.[1]

Judicial bonds should be interpreted in accordance with the same rules that apply to the interpretation of any other written instrument. The limitation of liability can never be

[1] 166 N. Y. 244; 56 N. E. 531.

predicated upon the interpretation, but in application of the contract after interpretation. Then only is there the slightest excuse for applying the rule of *strictissimi juris*.[1] If there be any ambiguity in the contract, it is to be construed in favor of the person who has accepted it and expects to take benefit under it.[2] In arriving at the correct construction of such a contract, it is always permissible to take into consideration the circumstances and surroundings of the parties at the time when the contract was made, and such construction will be given to it as will carry out the evident intent of the parties to the contract.[3]

The Supreme Court of Washington in a recent case[4] has specifically enunciated the principle, that the strict rule of construction applied in the case of gratuitous sureties and represented by the *strictissimi juris* rule, *has no application to the case of compensated sureties*. It is sincerely to be hoped that this forward step of the Washington Supreme Court will be followed generally in other jurisdictions.[5]

The rule applicable to ordinary judicial bonds and undertakings which permits gratuitous sureties to stand upon their strict legal rights, does not prevent, in the case of compensated sureties, a construction of their obligations, with a view to determining the fair scope and meaning of their contract in the light of the language used and the circumstances surrounding the parties.[6]

It has been well settled that judicial bonds are to be construed by the laws under which they are executed, rejecting

[1] Sachs *v.* Am. Sur. Co., 72 N. Y. App. Div. 60; 76 N. Y. Sup. 335.

[2] *Idem.*

[3] *Idem.*

[4] Quandt, *et al.* *v.* Fid. & Dep. Co., 38 Wash. 93; 80 Pac. 287.

[5] See also New Haven County Bank *v.* Mitchell, 15 Conn. 206; Mauran *v.* Bullins, 41 U. S. (16 Pet.) 528; Bank of Washington *v.* Barrington, 2 Penr. 2; State *v.* Spittler, *et al.*, 79 Conn. 470; 65 Atl. 949; Richardson *v.* People, etc., 85 Ill. 295; Claxton *v.* Anthony, 15 Grattan (Vt.) 518; Hare *v.* Marsh, 61 Wis. 435; Horner *v.* Lyman, 4 Keys 237; State *v.* Swinney, 60 Miss. 39; Levy *v.* Taylor, 24 Md. 282.

[6] See Mill *v.* Am. Sur. Co., 200 U. S., pp. 197, 203; Ulster Co. Sav. Ins. *v.* Young, 161 N. Y. 25, 30.

surplusage and supplying omissions.[1] In any event, the contracts of sureties are to be construed like other contracts, so as to give effect to the intention of the parties. In ascertaining that intention we are to read the language used by the parties in the light of the circumstances surrounding the execution of the instrument, and when we have thus ascertained their meaning we are to give it effect.[2] But when the meaning of the language used has been thus ascertained, the responsibility of the surety should not be extended or enlarged by implication or construction.[3]

§ 245. **Validity of Judicial Insurance Bonds.** — The acceptance of the bond, and the turning over of property to the "risk," or the extension of certain judicial privileges on the strength of its execution and approval, are a sufficient consideration to sustain the validity of the bond in that regard. When, as frequently happens, because of some irregularity in the form with respect to the statutory requirements, the bond must be regarded as invalid when considered as a statutory bond, nevertheless it can be enforced in very many cases as a common law bond. This principle is unquestionably applicable alike to judicial insurance bonds as well as to private bonds.

There can be no question raised at this late day as to the general validity of judicial bonds issued by the so-called surety companies. Whenever such companies possess the corporate power to issue such bonds, and have obtained the necessary permit to transact business in the locality where the bond is issued, all such bonds,

[1] St. Chas. St. Ry. Co. *v.* Fid. & Dep. Co., 109 La. 491; 33 Sou. 574; see also Slocomb *v.* Robert, 16 La. 173.

[2] Sachs *v.* Am. Sur. Co., 72 N. Y. App. Div. 60; 76 N. Y. Sup. 335.

[3] Doon *v.* Am. Sur. Co., 110 App. Div. 215; 97 N. Y. Sup. 270. See generally as to the admission of parol evidence to explain written instruments of the character now under consideration, the following cases: Am. Bond. & Tr. Co. *v.* Takahashi, *et al.*, 111 Fed. 125; Commonwealth *v.* Am. Bond. & Tr. Co., 16 Pa. Sup. Ct. 570; Home Sav. & Tr. Co. *v.* Fid. & Dep. Co., 115 Ia. 394; 88 N. W. 821.

if authorized by local statutes or ordinances, are unquestionably valid.[1]

On the general subject of the validity of judicial insurance bonds, the Supreme Court of Pennsylvania recently spoke as follows:[2]

"Viewed in this light, the act of 1895 is not at all within the prohibition. The objection is essentially based on the assumption that the suretyship of a corporation and of an individual are identical, and that the act therefore makes a discrimination between equally qualified sureties for the same service. But his assumption is not sustained by the evidence and overlooks the material distinctions between the quality of the security offered. These distinctions are obvious. The individual surety formerly was usually a relative or friend who had the confidence of the principal, and voluntarily assumed the obligation of answering for the latter's faithful performance of duty. I do not speak of the individual becoming a surety for pay, for the very name, the 'professional bail-goer,' is a reproach to every branch of the administration of justice which he was allowed to contaminate with his presence. But the voluntary surety, however honest and well qualified at the time of his approval by the court, is liable to the contingencies of business, the changes of value in property and the inexorable chance of death which brings his estate into the administration of the law under wholly changed circumstances. Of the happening of any of these contingencies the only person in a position to keep a close watch is the principal, and his interest is adverse to making known any doubt as to the sufficiency of his friend or to assume the burden of finding a new surety. These are some of the disadvantages even of an honest surety, and if we add to them the risk of a dishonest one who may dispose of his property on his own scent of danger or on a friendly hint from his principal, we may have a fair idea of the dangers of which our reports present many illustrations. On the other hand, the surety company included in the provisions of the act of 1895 must have a capital, the amount, nature of investment and management of which are known and within the constant sight of the court and persons interested; it is obliged to make report of its condition to the courts and to the commonwealth and is at all times subject to the visitorial power of the latter; and finally, it is

[1] See Mayne *v.* Fid. & Dep. Co. of Md., 198 Pa. 490; 48 Atl. 469; Flynn *v.* U. S. Sur. & Guar. Co., 61 N. Y. App. Div. 170; Borden *v.* Am. Sur. Co., 159 Pa. St. 465; 28 Atl. 301.

[2] Clarke's Estate, 95 Pa. St. 520.

the sharp incentive to prevention of loss by looking closely after the administration of his trust by its principal, for whom it has become responsible, not from friendly personal confidence, but as a strict business venture. It was said in this case, by the learned president of the orphans' court whose utterance entitles his opinion to great weight, that 'corporation suretyship,' another product of modern thought and ingenuity, may be said to possess many advantages over individual security. Our daily experience has proved that corporation security and the oversight and management by expert officers of the trust and security companies are highly advantageous not only to the fiduciary but to all the parties interested, whether creditors, legatees or distributees. But even if this be not so, it is plain that while the duties and liabilities of the surety, whether corporation or individual, are the same, and in those respects they stand upon the same plane, yet the qualities and advantages of the security afforded are materially different. It is on this difference that the discrimination under the act of 1895 is founded, and it is a fair and constitutional basis for the legislative discretion." [1]

§ 246. **Doctrine of Insurable Interest in Judicial Insurance.** — In Fidelity and Deposit Company *v.* Singer, *et al.*,[2] the Maryland court of appeals had occasion to touch upon the subject of insurable interest in judicial insurance while construing a replevin bond furnished by a guaranty insurance company. The bond in suit was given by the insurer to two individuals (O'Brien and Singer) as the insured at the request of the "risk," the plaintiff in the replevin suit. On the appeal therein the court spoke as follows:

"The uncontradicted evidence showed that neither O'Brien nor Singer, in their individual capacities, claimed any interest in the goods replevied, but that Singer claimed the entire property in the goods as trustee for the creditors of O'Brien, who was insolvent. And the question is: Inasmuch as O'Brien and Singer, as individuals, had no interest or right to the property seized under the writ of replevin, can a suit be maintained in their names for the use of Singer, trustee, for the creditors of O'Brien, against the surety on the replevin bond?

[1] See also State *ex rel.* *v.* Robins, 71 Ohio St. 273; Germantown Tr. Co. *v.* Whitney, 19 S. D. 108; St. Chas. St. Ry. St. Co. *v.* Fid. & Dep. Co. of Md., 109 La. 491; 33 Sou. 574; Baricklow *v.* Stewart, 31 Ind. App. 446; Mut. Life Ins. Co. of N. Y. *v.* Langley, 145 Fed. 415.

[2] 94 Md. 124; 50 Atl. Rep. 518.

Whilst O'Brien and Singer are the obligees named in the bond, can a recovery be had on the bond in a suit brought in their names for the use of Singer, trustee, if the latter is essentially a different person from Singer individually? Singer, as trustee, is not named in the bond at all. The contract of a surety on a replevin bond is a contract of indemnity, and nothing more. The surety undertakes and agrees to hold the obligee named in the bond harmless; that is, to see that the goods are returned, or their value paid, to the obligee by the principal in the bond, if the replevin suit be not prosecuted with effect, and if the obligee be entitled to the goods or their value. If the obligee has no interest in or right to the possession of the goods, a deprivation of them or of the possession of them can do him no substantial injury. A surety is never bound beyond the terms of his contract, and this means not only that he is not liable for a larger undertaking than he has assumed, but that he is not answerable to any other person than the one with whom the contract was made. A replevin bond is not, like a trustee's or executor's bond, payable to the state for the use of any one who may be or may become interested in the fund or in the estate, but is payable to the defendant in the replevin suit. Whilst a suit on it may be entered by the obligee to the use of another person, the obvious measure of the sum recoverable is the extent of the damages which the obligee might exact, and is not the amount which the equitable plaintiff who is not a party to the bond has sustained.

"If this were not so, a person not indemnified by the bond, because not named as obligee therein, could recover against the surety on the bond a sum in excess of that which the obligee himself could recover. The surety would then be held bound to a person with whom he did not contract, and in addition he would be made liable to the latter in a larger sum than to the person with whom he did contract. This cannot be, and hence it is clear that the extent of the right which the person to whose use the suit on the replevin bond is brought may have in the property replevied is not the measure of the surety's liability, but the extent of the right of the obligee in that property is the true measure of that liability. The assignee of the bond can have no greater right than the assignor has." [1]

It is fair to say that a careful reading of the foregoing case, as well as of others bearing upon the question leading to the conclusion that the doctrine of the necessity of the insured having an insurable interest in order to sustain the validity

[1] See Ausplund *v.* Ætna Indemn. Co., 47 Ore. 10; 81 Pac. 577.

of a judicial insurance bond issued to him, is as fully applicable in judicial insurance as it is in any other branch of insurance law.[1]

The Supreme Court of Texas[2] has recently declared the rule to be that the liability of the insurer under a judicial insurance bond can never be greater than the liability of the "risk" to the insured.

§ 247. **Parties to Judicial Insurance Bonds.** — The parties to judicial insurance bonds are, in the strict sense of the term, two in number, the insurer, or "surety company," as it is commonly termed, which for a consideration executes the bond, and the insured for whose direct benefit it is issued. Though the "risk" join with the insurer in the execution of the bond, he is not a necessary party to the contract of insurance, though upon proper application he may be made a party defendant with the insurer in an action brought by the insured to enforce the former's liability under a statutory bond. Thus, in Feinberg *v.* American Surety Company,[3] it was said that if the defendant, in an action wherein an attachment has been issued, sues upon the bond given to procure it, the "risk" named in such bond is entitled to be made a co-defendant therein, as he has such interest in the subject of the action as should entitle him to be joined as a party defendant therein. The court, in its opinion in this case, observed that "from a reading of the condition of the undertaking set forth, it is apparent that the appellant (the 'risk') is the principal, while the surety company (the insurer) is merely a surety for his obligation to pay the damages occasioned by the former's act in levying the attachment; but since the appellant's rights may be fixed and determined in

[1] Bamberger *v.* Am. Sur. Co., 96 N. Y. Sup. 665; 48 Misc. 221; Cohen *v.* Am. Sur. Co., 108 N. Y. Sup. 385; State of Maryland to Use of Morrow *v.* Fid. & Dep. Co., 100 Md. 256; 59 Atl. 735; Am. Sur. Co. *v.* Platt Adminis., 67 Kan. 294; 72 Pac. 775; Spencer *v.* Ætna Indemn. Co., 231 Ill. 82; 83 N. E. 102.

[2] Fid. & Dep. Co. *v.* Schelper, *et al.*, 37 Tex. Civ. App. 393; 83 S. W. 871.

[3] 33 N. Y. Misc. Rep. 458.

the present action, and as he will be liable to the surety company for any judgment that may be rendered against it, he has a direct interest in the present action, and he therefore may be permitted to intervene." This same question was also considered in a contract insurance case,[1] where the facts were as follows: One Nevins made an agreement to sell to one Mason certain real property on instalment, payments of said instalments to be secured by a contract insurance bond which was subsequently furnished by the Fidelity and Casualty Company at the request of Mason. Nevins subsequently brought an action against the "surety company," whereupon Mason made an application to the court to be made a party to the said action against the Fidelity and Casualty Company, on the ground that this was necessary to protect his interests as affected by the action brought on the part of Nevins. He further alleged that he was named in the contract insurance bond as the "risk," and had a good defence to the action brought by Mason, which would be lost to him unless he was made a party to the action, as the surety company could not avail itself of this defence in an action on the bond. In granting the application of Mason to be made a party to the action, the court spoke as follows:

"If judgment goes against the surety (the insurer), the petitioner, as principal (the 'risk'), will be liable over to the latter, and he can relieve himself from such liability if permitted to defend the action and establish his defence therein. He has, therefore, a direct interest in the subject of the action, to wit, the enforcement of the bond. The surety company cannot set up as defence the fraud which the petitioner charges. As the latter has not rescinded the contract of the sale of the premises, he has only a claim for damages which is not available as a defence to the surety; but if the principal and surety are sued together, a successful recoupment by the former will inure to the benefit of the latter, though the surety could not, if sued alone, avail himself of the defence. Great liberality is always shown in admitting parties who may be injuriously affected by the action and judgment."

[1] 12 N. Y. Misc. 77.

In all classes of judicial insurance bonds, no matter whether they run in name to the "people," "court" or "estate," they are executed for the sole benefit of those to whom the right of action thereon is given by statute.[1] Some courts have held that the right of action on judicial insurance bonds is not limited to the parties therein named, but may be maintained by their assignees.[2] These decisions are, to say the least, of doubtful authority.

It has been held, where a surety company issues an administration bond upon an administratrix, that it has power to accept from her the transfer of her right of action under a modifying surrogate's decree, by which, upon the discovery of the existence of other parties in interest, the amounts directed by a former decree to be paid by her to the next of kin were reduced; and that the insurer may thereafter maintain an action at law against the assignee of the shares of certain of the next of kin as established by the first decree, and who is also a party to both decrees, to recover erroneous overpayments made to him, as such moneys are to be deemed assets of the estate of the deceased which will belong to the persons entitled thereto.[3]

In Rhode Island the rule seems to prevail that, by reason of the absence of any privity of contract between the administrator *de bonis non* and the insurer issuing an administration bond to the former's predecessor, such an administrator has not the right to sue upon his predecessor's bond. The doctrine of this case is directly opposed by the New York decisions, which, however, seem to rest largely upon the provisions of local statutes.[4]

[1] See Dunne *v.* Am. Sur. Co., 43 N. Y. App. Div. 91; 34 N. Y. Misc. 584; Flanagan *v.* Fid. & Dep. Co., 32 N. Y. Misc. Rep. 424; Fid. & Dep. Co. *v.* Singer, 50 Atl. 518.

[2] Epstein *v.* Fid. & Guar. Co., 29 N. Y. Misc. 295; 60 N. Y. Sup. 527; see also Dunne *v.* Am. Sur. Co., 43 App. Div. N. Y. 97; 34 N. Y. Misc. Rep. 584.

[3] Law. Sur. Co. *v.* Reinach, 25 Misc. N. Y. 150.

[4] App. Div. of Sup. Ct. *v.* Law. Sur. Co., 21 R. I. 454; 44 Atl. Rep. 594; Dunne *v.* Am. Sur. Co., 43 App. Div. N. Y. 91; 34 N. Y. Misc. 484; Flanagan *v.* Fid. & Dep. Co., 32 N. Y. Misc. 424; 66 N. Y. Sup. 544.

In Flanagan *v.* Fidelity and Deposit Company[1] it was said that a substituted receiver may maintain an action on his predecessor's administration bond whenever that right is expressly given by statute. In such a case it seems that the statute is written into the administration bond at the time that it is executed.[2] The question at issue therein was whether the right of action did not have to be maintained by the parties to whom the original administrator had been directed to make payment out of the administration funds that had been dissipated.[3] In Cohen *v.* American Surety Company[4] it was held that a trustee in bankruptcy may bring an action on the bond of his predecessor, an assignee in insolvency.

CHAPTER XX

ADMINISTRATION INSURANCE BONDS

§ 248. **Administration Insurance Bonds — General Remarks.** — To secure the due administration of justice and to protect the property interests of all who look to the court for such protection, what may be termed administration insurance bonds are required by statute almost universally in this country, Canada and England. The more important of these bonds are those required of executors, administrators, guardians, trustees, committees, assignees and receivers. All are in a sense trustees to protect definite interests and are governed to a very large extent by the same general principles and rules. The nature of these administration bonds is that

[1] 32 N. Y. Misc. Rep. 424.

[2] See Cohen *v.* Am. Sur. Co., 192 N. Y. 227; 84 N. E. 947.

[3] See generally on the subject of parties to judicial bonds, the following cases: Mullins, etc. *v.* Fid. & Dep. Co. of Baltimore, 30 Ky. L. Rep. 1077; Alexander *v.* Union Sur. & Guar. Co., 85 N. Y. Sup. 282; Morrow *v.* Fid. & Dep. Co., 100 Md. 256; 59 Atl. 735; People *v.* Pacific Dredging Co., 130 Ill. App. Ct. 502; Am. Sur. Co. *v.* Wood, 2 Ga. 641; State *v.* Smith, Kline & French, 4 Penneqill (Del.) 428; 156 Atl. 607; Cohen *v.* Am. Sur. Co., 192 N. Y. 227; 84 N. E. 947.

[4] 192 N. Y. 227; 84 N. E. 947.

of a contract of indemnity to those who may suffer loss by reason of either the misfeasance or nonfeasance of the party whose faithful performance of official duty, in the course of the judicial administration of estates, is sought to be secured through the medium of such bonds. It has always been the policy of the courts to protect to the fullest possible extent those who by force of the law or without their consent are represented by others in the care of their property. It is to the existence of this policy that the universal requirement of administration bonds may be ascribed.[1]

§ 249. **Construction of Administration Bonds.** — While an administration bond should be fairly construed according to the reasonable rules for the interpretation of contracts, when the subject of the bond is finally ascertained, then and not till then has the insurer a right to insist upon a strict construction of the conditions of his continued liability. Parties to administration bonds have the right, and should specify the nature and extent of the obligation they enter into, and when they have done this, the courts have no right to say that something else amounts to the same thing, and that what has been done has caused no injury to the insurer, and thereby make a substantially new contract upon which to predicate a new liability on its bond.[2]

§ 250. **Attachment of Liability under Administration Insurance Bonds.** — With respect to the attachment of liability under administration bonds it may be said that the insurer is not liable in any event for acts or defaults of the "risk" committed prior to the execution of such insurance bonds.[3] In general, the period of duration of liability under such bonds, on the part of the insurer to the insured, is coextensive with that of the "risk" to the insured.[4]

[1] See *In re* City Tr., Safe Dep. & Sur. Co., 16 Pa. Dist. Rep. 195.

[2] See Guardian Tr. Co. *v.* Peabody, 107 N. Y. Sup. 515, 518.

[3] Moore, *et al.* *v.* Hanscom, Tex. ; 103 S. W. 665; Howe *v.* White, *et al.*, 162 Ind. 74; 69 N. E. 684; Brehm *v.* U. S. Fid. & Guar. Co., 124 Wis. 339.

[4] Fid. & Dep. Co. *v.* Schelper, *et al.*, 37 Tex. Civ. App. 393; 83 S. W. 871.

The insurer who issues administration bonds is bound by the recitals of the same with reference to the " risk's " appointment to the office to secure the faithful performance of the duties for which the bond is given. This is on the plainest principles of estoppel, for by its act in offering the bond the " risk " has obtained possession of the property of the insured. Therefore, it is safe to assert in this connection that the insurer is estopped from claiming that there has never been any attachment of liability under a judicial administration bond by reason of irregularity in the appointment of the " risk " to the position designated therein.[1]

The surety upon the bond of a testamentary trustee, providing that the trustee shall " faithfully execute the trust reposed in him " and " distribute and account for all property and moneys that shall come into his hands," is not liable for the failure of such trustee to account for moneys which came into his hands before the execution of the bond.[2]

§ 251. **Duration of Liability under Administration Insurance Bonds.** — As a general rule the liability of the insurer under an administration insurance bond is, in the absence of specific provision limiting the insurer's liability to a greater period, coextensive with the liability of the " risk " to the insured.[3] The engagement of an insurer under an administration bond is for the future, and it cannot be made liable for the past, in the absence of a specific covenant to that effect.[4]

§ 252. **Scope of Liability under Administration Insurance Bonds.** — It may be stated as a general rule that in the case of administration insurance bonds the insurer's liability

[1] See *ante*, § 142; as to execution of judicial bonds, see *post*, § 268.

[2] Thomson *v.* Am. Sur. Co., 170 N. Y. 109; 62 N. E. 1073.

[3] Brehm *v.* U. S. Fid. & Guar. Co., 124 Wis. 339; U. S. Fid. & Guar. Co. *v.* Davis, 2 Ga. App. 525; 58 S. E. 777; Howe *v.* White, *et al.*, 162 Ind. 74; 69 N. E. 684; Fid. & Dep. Co. *v.* Schuchman, *et al.*, Mo. ; 88 S. W. 626; *In re* Guardianship of Fardette, 83 N. Y. Sup. 521; 86 App. Div. 50; Fid. & Dep. Co. *v.* Schelper, *et al.*, 37 Tex. Civ. App. 393; 83 S. W. 871.

[4] Thomson *v.* Am. Sur. Co., 170 N. Y. 109; 62 N. E. 1073.

thereunder to the insured is coextensive with the "risk's" liability to the insured.[1] The provisions of law governing the subject-matter of administration bonds are to be read into the bond itself as if part and parcel thereof.[2]

By executing an administration insurance bond the insurer does not make himself privy to any order which may be made by the court directing the "risk" as to his official duties, nor is such bond violated by failure to obey such order, where the bond does not stipulate that the "risk" shall obey all orders of the court. However, if it does so stipulate, it would seem that such order is conclusive upon the insurer, and when the failure to obey the order is judicially established, the liability of the insurer is fixed. A case in point in this connection is that of Lesster *v.* Lawyers' Surety Company.[3] This was an action brought against the Lawyers' Surety Company to enforce its liability on an administration insurance bond issued upon one Ingraham as receiver appointed in mortgage foreclosure proceedings, wherein one Mary Harris was plaintiff, and one Lesster was defendant. The court in its opinion spoke as follows:

"The condition of the defendant's bond as surety was that, if the receiver should faithfully discharge his duties as such receiver, then the bond should be void. It is claimed by the plaintiff that the surety, by executing the bond, made himself privy to any order which should be made by the court directed to the receiver in respect to his duties; and that whenever it was made to appear that the receiver had failed to obey an order of the court, the condition of the bond was violated and the defendant became liable on it. This would be technically the case if the condition of the surety's bond provided in terms that the receiver should obey all orders of the court and should pay as directed by the court, or if there were any other express condition in the bond from which it might be inferred that the surety originally covenanted that the receiver should do the particular thing the court ordered him to do. Whenever such a bond has been made, as where

[1] State *v.* Spittler, *et al.*, 79 Conn. 470; 65 Atl. 945; Fid. & Dep. Co. *v.* Schelper, *et al.*, 37 Tex. Civ. App. 393; 83 S. W. 871.

[2] Cohen *v.* Am. Sur. Co., 192 N. Y. 227; 84 N. E. 947.

[3] 50 N. Y. App. Div. 181; 63 N. Y. Sup. 804.

one has given security for an administrator or an executor by the terms of which he has bound himself that the administrator will obey the orders of the surrogate, it has been held such an order properly made is conclusive upon the surety, and when the failure to obey the order is established, the liability of the surety is absolutely fixed. But those cases turn upon the express agreement of the surety that the administrator will obey the orders of the surrogate, and when such a contract has been made the courts say that by his contract the surety puts himself in privity with the administrator with respect to the decrees of the surrogate. But, unless the contract contains some provision from which it can be clearly inferred that the surety has come in privity with the principal so that he had bound himself to abide by the judgment against the principal, such an order is not conclusive against him, and he may question it when a liability is sought to be established against him on account of it. While the order of the court was evidenced against this surety, the defendant was nevertheless at liberty to show, not that the order of the court was improper, but that the apparent disobedience to it was not in fact a disobedience at all, for the reason that the receiver had before that time faithfully discharged his duties as such by paying over all the money in his hands in pursuance to another valid order of the court."

Practically it is immaterial, so far as the insurer's liability is concerned, whether incomplete administration, resulting from a failure to place estate funds in the hands of the insured, to whom they finally belong, is caused by their simple retention in the "risk's" hands, or by the latter's personal use or conversion thereof.[1] Where by reason of special circumstances the insured is unable to point to a literal breach of the conditions of a bond, but a breach has occurred in such conditions when interpreted according to the spirit of the bond, then equity will treat the same as a substantial and essential breach in every particular.[2]

In general, the scope of administration insurance bonds should not be extended by construction. Where the appointment of the "risk" in an administration bond is regular and is made in a matter over which the court has assumed jurisdiction, and the "risk" has taken possession of the property

[1] Dunne *v.* Am. Sur. Co., 43 App. Div. 91; 34 N. Y. Misc. 584.

[2] *Idem.*

and embezzled the proceeds, the insurer is liable on the bond, though the bill under which the " risk " was appointed was afterwards dismissed for want of jurisdiction.[1] The general rule in the case of administration insurance bonds is that the burden is upon the insurer, if he wish to absolve itself from liability on the bond, to see that his " risk " performs fully his obligations thereunder. The purpose of the bond is not only to protect the insured from fraud and dishonesty on the part of the " risk," but likewise to save the insured harmless in case of the latter's insolvency.

With reference to the insurer's liability, the " risk's " position is a personal trust, and the performance of his duties cannot be delegated to others. The insurer's liability continues during the life of the bond, or until it has been formally discharged therefrom, or the " risk " has accounted and shown a faithful administration of his trust.

The insurer, in the case of all administration insurance bonds, is liable for acts of both omission and commission on the part of the " risk."

It is often stated as a general rule that no action can be maintained upon the bond until proceedings for an accounting have been had against the " risk " or his default established in some formal proceeding.

But the rule does not obtain in several jurisdictions, notably in Illinois and Missouri.[2] In any event, where it appears that an accounting is impossible or impracticable, an action in equity to establish the extent of liability and to charge the insurer is proper.[3]

It is well settled that the unauthorized acts of the " risk " with relation to the assets of an estate are treated as his individual acts and do not estop him either from maintaining an action in his representative capacity for the possession

[1] See Bal. Bldg. & Loan Ass., *et al.* *v.* Alderson, *et al.*, 90 Fed. 498; 39 C. C. A. 609.

[2] See Bonham *v.* People, 102 Ill. 434; State *v.* Slevin, 93 Mo. 253.

[3] Otto *v.* Van Riper, *et al.*, 164 N. Y. 536; 58 N. E. 643.

of the estate entrusted to him or from suing for damages for injury to it.[1]

It is a rule of universal application in matters relating to administration insurance bonds that they only cover acts of the " risk " while acting strictly within the official capacity designated in such bonds.[2]

The scope of such bonds can never be extended by reason of the " risk " assuming to act in any other capacity than that designated therein.

The insurer cannot be held liable for any acts or defaults committed by the " risk " out of the line of his official duties. The insurer, in issuing such bond, merely binds itself for such acts of the " risk " as relate to some default in transactions, where the latter acts by virtue of his appointment by the court or for the omission of some act which, as an appointee of the court, it was his duty to perform. Hence, if the " risk " commit a wrong not connected with the discharge of his official duty, he is personally and not officially liable, and therefore his official bondsman cannot be held responsible therefor.[3]

In Hill *v.* American Surety Company, *et al.*,[4] it was held that an assignee who neglects to use ordinary diligence to procure insurance on the estate in his hands is liable on his official bond for negligence. The court, it was said, will take judicial notice of the fact that an ordinarily prudent man, having in his possession a large manufacturing establishment, keeps the same insured against loss by fire to an amount well approaching its real value. In its opinion the Wisconsin court used these words:

"It has always been the policy to protect those who, by force of the law or without their consent, are represented by others in the care

[1] Law. Sur. Co. *v.* Reinach, 25 Misc. 150.

[2] Farmers' and Traders' Bank *v.* Fid. & Dep. Co., 108 Ky. 384; 56 S. W. 671.

[3] See Am. Sur. Co. *v.* McDermott, 5 N. Y. Misc. 298; Law. Sur. Co. *v.* Reinach, 25 N. Y. Misc. 150.

[4] 81 N. W. 1024; 82 N. W. 691; 19 Wis. 107.

of their property. Hence the duty of the courts to hold the assignee to strict performance, first, of all orders which the court may make as to his conduct; and, secondly, where the court is silent, to the full measure of diligence and fidelity above suggested."

In McCollister *v.* Bishop, *et al.*,[1] it was held, with reference to trust funds, that any agreement on the part of the " risk " whereby he surrenders or limits his control over them, renders both the " risk " and the insurer liable for any loss that may occur, for the reason that both are in contemplation of law guarantors of such funds, irrespective of motives, or whether the " risk's " surrender of control was the cause of the loss. A duly appointed successor to the " risk " may sue on the administration bond of his predecessor as being the insured in contemplation of the insurer, when the policy was issued.[2] It is a general rule that the insurer issuing a bond on an executor, administrator or trustee does not become liable thereunder until the default of the " risk " has become fixed, and then only under the express terms of the bond itself.

A ruling on the scope of liability, somewhat novel in its character, is found in Dunne *v.* American Surety Company,[3] where it was held that an administrator *de bonis non* of an estate, appointed in the state of New York in place of a deceased administrator, may, without leave of court, and although the intestate left no debts, sue the surety on the bond of such administrator for moneys of the estate received by him, but for which neither he nor his executor has accounted or will account, and this although the deceased administrator removed from the state of New York to a foreign state, died there, and did not leave in that state either personalty or personal representatives.

A most instructive case with reference to the liability of an insurer on the bond of a trustee is that of Thomson *v.* American Surety Company.[4] In this case a bond was fur-

[1] 78 Minn. 228; 80 N. W. 1118.

[2] Flanagan *v.* Fid. & Dep. Co., 32 N. Y. Misc. 424.

[3] 34 N. Y. Misc. 584; 43 N. Y. App. Div. N. Y. 91.

[4] 56 N. Y. App. Div. 113; 67 N. Y. Sup. 564.

nished by the American Surety Company for one Cruikshank, named as trustee in a will. The conditions of this bond were to the effect that if said Cruikshank should faithfully execute the trust reposed in him as such trustee, and should faithfully pay over, distribute and divide and account for all the property and money which should come into his hands as such trustee in accordance with the provisions of the will under which he was appointed, then the bond was to become void. The latter was executed ten years after Cruikshank was appointed trustee and three years after the entry of a judgment in an action brought by one of the *cestuis que trusts* adjudging that the sum of $83,653.33 was held by Cruikshank as trustee. An action was brought against the " surety company " on its bond to recover damages for alleged unfaithfulness on the part of Cruikshank as the " risk " named therein in the performance of his duties as trustee. On the questions of law raised in the trial of said action, the court spoke as follows:

"There was nothing in this bond which made this surety responsible for any failure to execute the trust prior to the execution of the bond, or by which the surety becomes liable for money which had come to the hands of the trustee prior to its execution. It was not conditioned upon the trustee's accounting for all property which had come into his hands prior to its execution, but was conditioned upon his paying over, distributing and dividing and accounting for all the property and money which should come to his hands as such trustee. It would undoubtedly include all property that was actually in his hands undistributed at the time of the execution of the bond; but to entitle the plaintiff to recover in this action it is apparent that there must be proof that Cruikshank, after the execution of the bond, had failed to faithfully execute the trust reposed in him as such trustee or had failed to faithfully pay over, distribute and divide and account for all the property and money which was in his hands at the time of the execution of the bond or which after its execution had come to his hands. . . .

"In the present action there was no evidence as to the failure of the defendant to faithfully perform the duties of his trust, or failure to account for and pay over to the beneficiaries of the estate the moneys in his hands, except so far as this judgment was evidence against the defendant. If this bond had been given upon the appointment of

the trustee so that the defendant should become the surety for the accounting by the trustee for all the moneys that should at any time during the trusteeship come into his hands, I should have no doubt that the judgment would be conclusive upon the surety as to the amount of money which had come into his hands as such trustee, and as to the amount of money for which he had failed to account. The bond recited the appointment of the principal as trustee by an order of the Supreme Court. The surety would be chargeable with notice of the order appointing the trustee, and the duties and responsibilities imposed upon the trustee by virtue of his appointment. He was appointed as a substituted trustee by the Supreme Court. Upon such an appointment the trustee is required to account to the court that appointed him, and the accounting specified in the bond is necessarily an accounting to the court; and when a surety undertakes that a trustee appointed by the court will faithfully account for all the money that comes into his hands, it would seem to follow that it was an accounting to the court in a proper judicial proceeding that was contemplated by the parties. It could add nothing to the effect of this provision of the bond to have provided that such an accounting must be before the court having cognizance thereof, as by the very terms of the appointment and the duties assumed by the trustee thereof, it was an accounting to the court that appointed him, or some other court having jurisdiction of the trustee, which would have been necessary to relieve him from liability, and it must be assumed, I think, that it was such an accounting that was contemplated by the parties when the bond in suit was executed. The bond was conditioned upon the faithful accounting by the trustee, and such an accounting must necessarily be to the authority that conferred the appointment upon him. I think that if this judgment had contained any adjudication that the trustee had failed to account for any money in his hands at the time of the execution of the bond by the defendant, or which came into his hands subsequently, the judgment would have been conclusive upon the defendant, and the defendant would have been bound by its adjudication. . . . The trustee claims certain payments as credits which were disallowed, but all of these payments were made long before the bond in suit was executed. There was no evidence, therefore, that the trustee had failed to account for any moneys which were in his hands at the time of the execution of this bond by the defendant, or that thereafter came into his hands. As before stated, the obligation of this surety is for the future. If the trustee shall faithfully execute the trust reposed in him as such trustee, and shall faithfully pay over and distribute and render an account

for all the moneys and property which should come into his hands as such trustee in accordance with the provisions of the said will, the obligation is to be void. . . . The rule is well settled that where the engagement of the surety is for the future, he cannot be held liable for the past as to which he has not covenanted.

"In this case the trust covered a considerable period before the bond sought to be enforced was executed. Under this bond the defendant was liable for any failure of the principal to account for all property and money which should come into his hands as such trustee; and the proof offered upon the trial was a judgment in an action brought against the trustee's executrix for an accounting, from which it appeared that the trustee had failed to account for certain sums of money which had come into his hands prior to the time that the bond in suit was executed; and although I think this judgment would have been conclusive if it had adjudicated that the trustee had failed to account for moneys which had come into his hands after the execution of the bond, as there was no such adjudication, and as the whole record shows that the action was brought to compel an accounting by the trustee for money which he had received long before the execution of the bond, the judgment was not, I think, evidence against this defendant of a breach of the condition of the bond which would entitle the plaintiff to recover. It follows that the judgment should be affirmed, with costs."

In a recent case it appeared that property in possession of a life tenant was to be sold under foreclosure. The guardian of the remainder-man, alleging that the sale of the property would cause great loss to her ward, procured the appointment of a receiver who was authorized to take charge of the property subject to the orders of the court and required to file a bond conditioned for the faithful performance of the trust reposed in him, or which might be reposed in him by any future order. The property was sold under foreclosure, and the guardian purchased it from the receiver, and he in her behalf filed exceptions to the ratification of the sale. The receiver then borrowed money to pay the amount due the mortgagee to refund a deposit made by the guardian at the time of the sale, it being agreed, however, that the guardian should not be relieved of her liability on account of the sale to her. Later the receiver received from

the guardian a payment stated to be on account of the mortgagee, and this payment the receiver did not use as intended or accounted for. It was held that the payment was not made to the receiver in connection with the management or care of the property and that the surety on his bond was not liable for its misapplication.[1]

It is well settled that the unauthorized acts of an administrator or executor with relation to the assets of an estate are treated as his individual acts, and do not estop him in his representative capacity or the sureties on his bond from maintaining an action for the recovery of the property wrongfully disposed of by him. Furthermore, when third persons sustain any damage by reason of the tortious or negligent acts of the personal representatives in the course of administration proceedings, the administrator is personally responsible, and a like responsibility attaches to him where no direct pecuniary advantage has resulted to the estate.[2]

Where, after one qualified as receiver of a corporation in an action in a state court and received and disbursed money, bankruptcy proceedings were brought against the corporation, and he qualified as trustee and filed his accounts in the state court to close the receivership, it was improper in the

[1] Preston *v.* Am. Sur. Co. of N. Y., *et al.*, 104 Md. 40; 64 Atl. 292. See generally on scope of liability under administration insurance bonds: Anderson *v.* Fid. & Dep. Co. of Baltimore, *et al.*, 100 Ga. 739; 28 S. E. 463; Lesster *v.* Law. Sur. Co., 30 N. Y. Misc. 771; Morgan, *et al. v.* Fid. & Dep. Co., 101 Ga. 389; 28 S. E. 857; Matter of Hazard, Petition of Am. Sur. Co., 73 Hun. 22; Fid. & Dep. Co. *v.* M. Rich & Beers, 122 Ga. 506; 50 S. E. 338; Commonwealth to Use of Cowles *v.* Am. Bond. Co., 212 Pa. 365; 61 Atl. 939; State to Use of Smith, Kline & French Co. *v.* U. S. Fid. & Guar. Co., 4 Penn. 428; 56 Atl. 607; Baum *v.* U. S. Fid. & Guar. Co., 19 Pa. Sup. Ct. 23; Preston *v.* Am. Sur. Co., 104 Md. 40; 64 Atl. 292; Commonwealth *v.* Am. Bond. Co., 25 Pa. Sup. Ct. 145; U. S. Fid. & Guar. Co. *v.* State *ex rel.* Smith, Ind. ; 81 N. E. 226; Burgess *v.* Am. Bond. & Tr. Co., Me. ; 69 Atl. 573; Am. Bond. Co. *v.* State, Ind. ; 82 N. E. 548; Frazer *v.* Fid. & Dep. Co., Ky. Ct. of App. ; 89 S. W. 134; Bassit *v.* Fid. & Dep. Co., 184 Mass. 210; 68 N. E. 205; Matter of Fardette *v.* U. S. Fid. & Guar. Co., 86 N. Y. App. Div. 51.

[2] Law. Sur. Co. *v.* Reinach, 25 N. Y. Misc. 150.

bankruptcy proceedings to summarily order him as trustee to pay into the treasury all moneys received by him as receiver in the state court, since he is entitled to present his accounts to a court and have his claim for credits for payments, as reported, passed on.

Though bankruptcy proceedings brought against a corporation in the hands of a state court receiver suspend further administration of the corporation's estate in the state court, it remains for that court to transfer the assets, settle the receiver's accounts and close its connection with the matter, and any errors committed in so doing could be rectified in due course in the designated way.[1]

§ 253. **Discharge of Liability under Administration Insurance Bonds.** — The insurer in administration insurance bonds may be discharged from liability thereunder in any one of the following ways:

First. By rescission of the contract or by cancellation of the bond.

Second. By misrepresentation.

Third. By concealment.

Fourth. By breach of warranty.

Fifth. By breach of the conditions of the bond on the part of the insured.

Sixth. By settlement of liability under the bond with the insured, either when such settlement is made by the insurer directly, or by the "risk."

§ 254. **Discharge of Liability by Rescission of the Contract or by Cancellation of the Bond.** — Any insurer has a right to rescind a contract of judicial insurance, when he has been induced to sign the same by the fraud of the insured, on proper application to the court.

Usually the grounds upon which the surety may ask to be relieved from liability on an administration bond are pointed

[1] Loveless *v.* Southern Grocer Co., Ltd., *et al.*, 159 Fed. 415; see also Wilson's Assignees *v.* Fid. & Dep. Co., 25 Ky. L. Rep. 1065; 76 S. W. 1095.

out by statute. Notwithstanding this fact, such surety may ask for his discharge on grounds other than those named in the statute. In National Surety Company *v.* Morris,[1] the Georgia Supreme Court said that, in addition to the statutory grounds, "want of personal integrity, lack of business capacity, extravagant or reckless living, indulgence in vicious or immoral habits, criminality and scores of other things might be suggested, which would certainly afford good reason for a desire to be relieved as surety. An insurer, under circumstances tending to show reasonable grounds for fear, is not obliged to wait until he becomes liable for actual waste and mismanagement before applying for relief."

It has been said that where the ultimate object of proceedings taken in court is to procure the release of the insurer from responsibility on account of some future breach of the condition of an administration bond, and no breach of the condition of such bond having occurred, and it appearing that none can possibly occur in the future, and that the duties, to secure the faithful performance of which the bond was given are now impossible of performance, the court will make no direct order for the filing of a new bond with a view to discharging the insurer from liability on the original administrator's bond.[2]

But the foregoing doctrine is modified somewhat by a late decision of the New York court of appeals, in American Surety Company of New York *v.* Thurber.[3] Here the "risk" named in an administration bond (a committee of a lunatic) made an agreement with the "surety company" furnishing the same, that the latter's acceptance of a premium from the former should not abridge any right or remedy which it might otherwise have. In view thereof it was held that it was entitled to apply to be relieved from its suretyship under a provision of the New York Code providing that sureties

[1] 36 S. E. 690; 111 Ga. 307.

[2] Matter of McCormick, 25 N. Y. Misc. 136.

[3] 56 N. E. 631; 162 N. Y. 244.

on the bond of a lunatic's committee may be relieved on petition for acts done by such committee after an order discharging them as sureties, though the committee has not been guilty of misfeasance or a breach of the contract, to secure the faithful performance of which the bond was issued.

It was held that a statute allowing a discharge on account of such acts must be held to apply to compensated as well as private sureties, and in making this holding the court spoke as follows:

"Surety companies are a convenience to the community, and it is important that they should continue sound and able to respond to their obligations. The legislature doubtless intended to promote their stability by extending the same protection to them that it extends to other sureties. The contracts of such companies are usually based upon an annual premium for a continuing bond. If the premium were not paid after the first year, and the company could not avail itself of the privilege of the statute (providing for the release of sureties for acts of commission or omission of the 'risk'), its responsibility would continue with no compensation, for the bond would still be in force. No company can do business on such a basis. Moreover, if the annual premiums are paid, but the principal is squandering the estate, how can a surety company protect itself? Through its officers it may inform those interested, and request action on their part, but if they reply, 'you are good, and we are safe,' what relief is there unless it is under this section? If it cannot induce those ultimately entitled to the money or property to act, its condition is hopeless, and bankruptcy may be the result. These considerations and others of like character may well have influenced the action of the legislature when it amended the section under consideration. The provisions of the statutes authorizing the company to become a surety are part of the contract of suretyship, and were not waived by accepting the contract of indemnity which expressly provides that acceptance of security or consideration should not 'limit or abridge any right or remedy which the surety might otherwise have.'"[1]

[1] Matter of Thurber, 162 N. Y. 244. See on statutory right to release from liability on an administration insurance bond the following cases: *In re* U. S. Fid. & Guar. Co., 98 N. Y. Sup. 217; 50 Misc. 147; U. S. Fid. & Guar. Co. *v.* Peebles, 100 Va. 585; 42 S. E. 310; Clarke *v.* Am. Sur. Co., 171 Ill. 235; *In re* Pope's Estate, Me. ; 69 Atl. 616.

It has been held under the statutes of Minnesota, that the failure on the part of an assignee to pay the agreed premium on his bond is sufficient ground for an application on the part of his surety for the former's removal from his position.[1] Where, however, the discharge of the insurer is procured on the ground of the principal's misrepresentations, and this last is procured through fraud, this should not operate to relieve either the principal or the insurer from liability.

In this connection attention is called to the case of Rich and Brothers *v.* Fidelity and Deposit Company of Maryland.[2] Here the plaintiffs obtained a judgment against the guardian upon an open account, which was not properly a debt of the ward's estate, and the refusal to pay which did not (in the decision referred to) constitute a breach of the bond. After that decision another suit was brought for the same cause of action, with the additional allegations that the guardian had received the proceeds of a life insurance policy, in which the wards had an interest; that the surety filed a petition alleging that the guardian had mismanaged the estate and violated the law, and seeking to be relieved from the bond; that the plaintiffs as creditors objected to the discharge of the surety; that in answer to the rule *nisi*, the guardian filed final returns in which were included the amounts due to the plaintiffs; that the surety knew of this and was a party to the crediting of such sums in the final returns; that the sole purpose was to relieve it as surety on the bond; and that if such amounts had not been allowed in the returns as constituting a part of the expenditures of the guardian, they would now be in the hands of the guardian to liquidate petitioner's claim. It did not appear that the surety was charged. It was held (1) that this did not operate as an estoppel by judgment on the surety, because the allowance of the returns was not a judgment in a proceeding to which the surety and the present plaintiffs were parties, although the making of the

[1] Am. Sur. Co., *et al.* *v.* Nelson, 77 Minn. 402; 80 N. W. 300.
[2] 126 Ga. 461; 55 S. E. 336.

return by the guardian may have resulted from a proceeding on the part of the surety to obtain a discharge from the bond.

(2) The statements in the return of the guardian were not solemn admissions *in judicio* by the surety, although the latter may have instigated or approved them, and they may have been for its benefit. (3) Considered as an estoppel by admission or in pais, no action on the part of the creditors in reliance upon such statements appears and no injury resulting to them. (4) Whether or not the making of such a return and the participation therein by the surety operated as a fraud upon the wards or would furnish any basis for action by them relatively to the creditors now suing, a return, claiming that such items were purported to be allowed to the guardian and the obtaining of the approval of the return, although participated in by the surety, would not render it liable to such creditors for the amount of their claim, if, in fact, it had not been paid, and was not one, the refusal to pay which would, in law, make the surety liable on the bond.[1]

§ 255. **Discharge of Liability by Misrepresentation.** — The opportunities for the insurer to escape liability under administration insurance bonds on the ground of misrepresentation made to him by the insured at the time the contract was entered into are unquestionably very limited. The duties of the " risk " in these cases are usually defined by law and must be performed under the guidance and direction of the court. Beneficiaries under such bonds do not have usually any part in procuring the same, as this duty is generally attended to by the " risk," who provides the bond in compliance with the express provisions of the statutes that govern and control the entire subject-matter of administration bonds. This fact alone takes away in a large measure from the insured the opportunity, even if it desired it, to misrepresent facts to

[1] See also Rich & Bros. *v.* Fid. & Dep. Co., 122 Ga. 506; 50 S. E. 338. See generally on the subject of rescission of contract in judicial insurance, Fid. & Dep. Co. *v.* Moshier, *et al.*, 151 Fed. 806.

the insurer in connection with the procuring of an administration bond.[1]

An interesting case on the subject of misrepresentation in the case of administration bonds is Fidelity and Deposit Company *v.* Moshier, *et al.*[2] The facts in this case, briefly stated, are as follows: A man owning a mercantile business died intestate, leaving a considerable indebtedness, the largest creditor being his father and mother. At a meeting of the family, at which his father and mother were present, it was ascertained that his personal estate was insufficient to pay his debts, and, at the suggestion of his father and mother, it was agreed that the widow and eldest son should be appointed administrators and, with intent of settling up the estate, agree to allow them to continue the business and first pay up the outside creditors. On their appointment they procured the plaintiff to become surety on their bond by making materially false representations as to the condition of their estate in their application and also promissory statements which they did not intend to and did not fulfil. The business was carried on for over a year, using money of the estate, and then sold to the administrators and others who thereafter became insolvent. On final settlement of their accounts they were charged with a considerable sum as in their hands which they were unable to pay. All creditors of the estate had been paid except the decedent's father and mother. It was held, that as against them, the plaintiff was entitled to a cancellation of its bond as having been procured by false representations to which they were privy as well as to the maladministration of the estate. The court in its opinion spoke as follows:

"It is evident that here was an existing agreement to put this personal estate into the hands of administrators, and that they should manage, conduct and continue it, not in accordance with law, not in the proper discharge of their duty as such administrators, not in the interests of all the creditors, but in the interests of those creditors

[1] See Rich & Bros. *v.* Fid. & Dep. Co., 126 Ga. 461; 55 S. E. 336; 122 Ga. 506; 50 S. E. 338; Law. Sur. Co. *v.* Reinach, 25 N. Y. Misc. Rep. 150.

[2] 150 Fed. 806.

not a party to the agreement and of the sons. Thereafter application was duly made for the appointment of said Carrie H. Moshier and James C. Moshier as administrators of said estate, and that they under their hands and seals on the 26th day of September, 1899, applied to the complainant to write and execute for them, as such administrators, and as their surety, a bond in the penal sum of $40,000, conditioned as required by the laws of the state of New York. This application contained certain promissory statements, among others, in substance, that the funds of the estate were to be deposited to their credit as administrators; that the funds were not to be invested, 'but as soon as notes to creditors expire will be used as far as possible to pay the debts and balance held for distribution at the end of year.' As to existing facts, they stated the value of accounts and notes to be $12,000, of stock and machinery to be $8000, real estate to be $50,000. They gave liabilities of the estate as 'Accounts in said business to be $10,000, notes about $4300, mortgage on real estate $18,000.'"

"It is evident that, in view of the knowledge they had gained at the interview referred to, here were materially false statements and representations, unless it was intended and understood and agreed that the claim of the mother and father of the intestate were executed as liabilities. All the representations and statements were certified to be true. No mention was made of the arrangement, the undertaking and agreement above stated, and that agreement was not made known to the Fidelity and Deposit Company, the complainant here, at any time during the accounting. It is quite apparent that, had it been made known, the complainant would not have written and issued the bond in question. It was the concealment of a material fact. The applicants also stated that it would 'deposit all moneys and things belonging to the estate now on hand and also such moneys and funds as may come into our hands from time to time during the administration of said estate from any source whatever in the bank or banks aforesaid, such money to be withdrawn only upon checks in our fiduciary capacity for the purposes connected with the administration of the trust.'

". . . It is claimed that the complainant has suffered no damage or loss by reason of the concealed agreement for the maladministration of the estate, inasmuch as the surrogate has found and charged the administrators with a profit realized from the business, and therefore, as no loss was sustained in carrying on the business in the manner stated for about one year and four months, the complainant is not entitled to any relief. But this contention fails to take into considera-

tion the further fact of the delay in closing up the estate, the expense of the running of the business, the time the administrators put into it, and their living expenses during that time, for which no compensation or remuneration was or could be allowed, and that, soon after the purchase by the administrators and the others named, all became insolvent and made the assignment. It fails to take into consideration the change of conditions, the increased peril of the estate and the fact that, by reason of the agreement, the complainant became surety not for the faithful performance of their duties by the administrators, but for a violation of their duty, a fact which Sarah M. Moshier and John G. Moshier knew, for they are presumed to have known the law and the legal effect of such an agreement. The administrators cannot now make good and pay the amount of the decree, and if the relief asked is not granted, the complainant must make up the deficiency. This condition or situation is largely the result of the action, advices and procurement of said John G. Moshier, and assented to and sanctioned by Sarah M. Moshier. Neither of them took any action whatever to have the estate closed or made any objection to the manner of conducting the estate, nor did Boshart until after the failure of the administrators."

§ 256. **Discharge of Liability by Concealment.** — That the liability of an insurer under an administration bond may be barred by fraudulent concealment on the part of the insured is clearly established by the case of Fidelity and Deposit Company *v.* Moshier, *et al.*[1] In that case the court spoke as follows:

"The question then is, can this bond of the administrators, executed by the surety company, be cancelled so far as these persons are concerned, or its enforcement against it by them be enjoined because of the fraudulent concealment of the agreement and not having disclosed it, and the other without consideration claiming under and through another who was also a party to the agreement and did not disclose it; neither was a party to the application for the bond, but both knew a bond must be given and both knew that the carrying out of the agreement constituted a violation of law and a maladministration of the estate, and a violation of the condition of the bond, which was as follows:

"'The condition of this obligation is such that if the above bonded Carrie H. Moshier and James G. Moshier shall faithfully execute the trust reposed in them as administrators, all and singular, the goods,

[1] 150 Fed. 806.

chattels and credits of Charles Moshier, deceased, and obey all lawful decrees and orders of the surrogate's court of the county of Oneida, touching the administration of the estate committed to them, then this obligation to be void, else to remain in full force and virtue.'

"In short, they knew they had contracted with the administrators in advance that they would and should violate the condition of their bond and increase the peril and obligation of the surety or sureties on their bond. Can one who induces and agrees with another that such other shall violate a trust obligation and duty which he is to undertake for the benefit of that one and others and which it is agreed he shall undertake for the faithful performance of which duty and obligation that other is to and does furnish surety, have any benefit or remedy on the undertaking of the surety, even if such one obtains no pecuniary benefit or gain or advantage, but, on the contrary, suffers loss from such breach of duty? A statement of the proposition would seem to furnish its own answer. The contract of the administrators is that they will faithfully perform and discharge their duties according to law, account and pay over, etc.; in reliance thereon the surety furnishes the bond and undertakes to answer for any and all violations of its conditions. This obligation extends to and protects all persons interested in the estate. If, however, the administrator, being a distributee and entitled to share, wastes the estate, it is clear he must look to the surety to make good to him his own default. Is it not equally clear that all persons entitled to share in the estate in any way who have induced and procured such default and waste and violation of the condition of the bond are precluded from enforcing or taking any benefit under it? Is it not a fraud on the surety? And the court will not stop to investigate and ascertain how much injury has been done to the surety by any such action, but will hold the surety released from all liability thereon and all responsibility to such wrongdoers. Public policy requires such to be the rule. Such agreements and understandings should be discouraged, else no surety on the bond of an administrator is safe." [1]

§ 257. **Discharge of Liability under Administration Bonds by Breach of Warranty.** — That the doctrine of warranty as it exists in fidelity and contract insurance is equally applicable to judicial insurance is well established. Thus, in a recent Connecticut case,[2] an attempt was made to escape

[1] See to the same effect, Am. Nat. Bank *v.* Fid. & Dep. Co., 129 Ga. 126; 58 S. E. 867.

[2] Bulkey *v.* House, *et al.*, 62 Conn. 459, 470; 26 Atl. 352.

liability on the ground that there had been a breach of implied warranty on the part of the insured in warranting that the "risks" named in an administration bond would act jointly and not singly. In its opinion in that case the court spoke as follows:

> "It is easy to insist that A might be willing to become surety for its faithful execution of the trust by X and Y, acting jointly, when he might be quite unwilling to accept the responsibility of one of them acting alone; and that the obligation in the latter case might, in fact, be a more serious one than the former.
>
> ". . . The contract of suretyship is construed strictly both at law and in equity; and the liability of the surety cannot be extended by implication beyond the authorized terms and scope of his engagement."

A case somewhat similar is State *v.* Spittler, *et al.*[1] The facts in this case, briefly stated, were as follows: Having been appointed temporary receivers, two of the defendants, Spittler and Corbin, as principals, and the third defendant as surety, gave a joint and several bond, the condition of which, after reciting such appointment, provided that, if appointees well and truly perform their duties under such appointment and under any future confirmation or appointment, either as temporary or permanent receivers, then the bond should be void, otherwise to remain in full force and effect. It was held, that the language clearly contemplated and provided for an original joint or associated receivership, and also for its continuance by confirmation or reappointment; that there was an entire absence of any suggestion of a willingness on the part of the signers to become responsible for the faithful discharge of the duties of the receivership after a severance of the joint relationship, and therefore upon the termination of the dual relationship and the substitution of Spittler as sole permanent receiver, the situation with reference to which the bond was given, ceased to exist, and its signers, other than Spittler, were not liable for his subsequent misconduct.

[1] 79 Conn. 470; 65 Atl. 949.

§ 258. **Discharge of Liability under Administration Bonds by Breach of Conditions.** — The courts are inclined to enforce with reasonable strictness any violation on the part of the insured of the conditions of an administration bond. The same general rules, applicable to a breach of the conditions of policies of fidelity and contract insurance, are equally applicable to administration bonds.[1]

§ 259. **Notice and Proof of Loss.** — Unless the governing statute or the bond specifically provides that notice of loss shall be given, with a certain designated time after discovery thereof, such notice is not necessary in order to establish liability under the bond. In People *ex rel.* American Surety Company *v.* Anthony,[2] it was intimated that the insurer is not entitled to notice of the "risk's" failure to perform his duties, where they consist of a failure to pay over the amount ascertained to be due in a settlement suit. "It would seem," observed the court, "that the obligation assumed by the surety upon the bond of an assignee for the benefit of creditors is strictly analogous to that assumed by a surety of a personal representative. The duties imposed by law upon these two classes of fiduciaries are almost exactly similar. Each administers the estate committed to his charge, pays the debts, and pays over to those entitled the surplus found to be due upon his settlement. That the surety of a personal representation undertakes that his principal shall pay over the amount so found to be due on settlement has been uniformly recognized." [3]

Where such notice is required to be given, the same rules

[1] See Stratton *v.* City Tr., Safe Dep. & Sur. Co., 83 N. Y. Sup. 780; 86 App. Div. 551; Bauschard Co. *v.* F. &. C. Co. of N. Y., 21 Pa. Sup. Ct. 370; Am. Nat. Bank *v.* Fid. & Dep. Co., 129 Ga. 126; 58 S. E. 867; *Ex parte* Rushford, 10 Vesey 410; Buffalo Ger. Ins. Co. *v.* Fid. Guar. & Tr. Co., 99 N. Y. Sup. 883; Wilson's Assignees *v.* Fid. & Dep. Co., *et al.*, 25 Ky. L. Rep. 1065; 76 S. W. 1095.

[2] 7 N. Y. App. Div. 132.

[3] Nat. Sur. Co. *v.* Arterburn, 110 Ky. 832; 62 S. W. 862; Stratton *v.* City Tr., Safe Dep. & Sur. Co. 83 N. Y. Sup. 780; 86 App. Div. 551.

are applicable thereto as apply in fidelity and contract insurance. With respect to proof of loss, they vary according to the peculiar nature of each case. Oftentimes the proof offered is a judgment obtained by the insured against the "risk." Again, it may be a final order or judgment or decree in an accounting had between the insured and the "risk." Still, again, the proof required may be evidence that the "risk" during the life of the bond was lawfully charged with certain money or property, and that in a proper action or proceeding has failed to account for the same. In all such cases inventories, schedules, returns, statements of accounts, etc., would be admissible in evidence in behalf of the insured to charge the "risk" therewith, and are equally applicable as against the insurer in favor of the insured to enforce the former's liability under the bond.

With respect to the settlement of the insurer's liability, the most practical question in administration bonds is that which relates to the effect of judgments obtained by the insured against the "risk" upon the question of the insurer's liability to the insured. In this connection it should be first noted that the liability of the insurer is generally coextensive with that of the "risk" to the insured.[1] In other words, if the obligation of the "risk" to the insured is destroyed, the incident — the obligation of the insurer — is destroyed.[2] The general rule is that a default of the "risk" must be established in proper proceedings against him before any liability can be enforced by action upon the administration bond. This for the reason that it is presumed in such cases that the "risk" performed his official duties until the contrary is affirmatively proven.[3]

It has been said that "it may well be considered as an established principle that whenever a surety has contracted,

[1] Fid. & Dep. Co. *v.* Schelper, *et al.*, 37 Tex. Civ. App. 393; 83 S. W. 870.

[2] Moore *v.* Hanscom, Tex. ; 106 S. W. 876.

[3] Rich & Bros. *v.* Fid. & Dep. Co. of Md., 126 Ga. 461; 55 S. E. 336; Fid. & Dep. Co. of Md. *v.* Schelper, *et al.*, 37 Tex. Civ. App. 393; 83 S. W. 870.

with reference to the conduct of the parties in some suit or proceedings in court, he is, in the absence of fraud and collusion, concluded by the judgment." Thus a judgment obtained against the executrix of such trustee for the balance of trust funds undistributed and unaccounted for at the time of his death, in an action brought by a substituted and succeeding trustee, is not evidence, in a subsequent action brought by that trustee against the surety for such balance, of the amount of damages to which such trustee is entitled for the alleged breach of trust of the deceased trustee, since the judgment against such executors is a judgment *in personam* by which only privies are bound, and there was no privity between the surety and the executrix of the deceased trustee.[1]

But it has been claimed that the foregoing is not a correct statement of the law except as it applies to what are termed "administration bonds." In order that the sureties may be conclusively bound by judgments against their principals, they must agree to be so bound in their bond.[2]

It has been said that it is a fundamental principle in jurisprudence that every man shall have his day in court, and shall

[1] Thomson *v.* Am. Sur. Co., 170 N. Y. 109; 62 N. E. 1073; see also State *ex rel.* *v.* Sur. Co., 76 Mo. App. 227; People *ex rel.* Am. Sur. Co. *v.* Anthony, 7 N. Y. App. Div. 132. As to necessity of making demand on surety, see U. S. Fid. & Guar. Co. *v.* Davis, 2 Ga. App. 525; 58 S. E. 777. As to proof of loss based upon an accounting, see Stratton *v.* City Tr., Safe Dep. & Sur. Co., 74 N. Y. Sup. 670; Carpenter *v.* U. S. Fid. & Guar. Co., 123 Wis. 209; 101 N. W. 404. As to return of guardian as evidence against a surety, see U. S. Fid. & Guar. Co. *v.* Davis, 2 Ga. App. 325; 58 S. E. 777. See the following cases holding judgments in favor of the insured against the "risk" to be conclusive upon the surety: Carpenter *v.* U. S. Fid. & Guar. Co., 123 Wis. 209; 101 N. W. 404; Fid. & Dep. Co. *v.* Nesbitt, 119 Ga. 316; 46 S. E. 444; Frazer, etc. *v.* Fid. & Dep. Co., 25 Ky. L. Rep. 473; 76 S. W. 31; S. W. 13; Bamberger *v.* Am. Sur. Co., 96 N. Y. Sup. 665; 48 Misc. 221; State *v.* Bergfield, 108 Mo. 631; Wilson's Ass. *v.* Louisville Nat. Bank Co., 25 Ky. L. Rep. 1065; 76 S. W. 1095; Garvey *v.* U. S. Fid. & Guar. Co., 77 N. Y. App. Div. 391; Preston *v.* Am. Sur. Co., 104 Md. 40; Thomson *v.* Am. Sur. Co., 170 N. Y. 109; 62 N. E. 1073.

[2] See Thomson *v.* Am. Sur. Co., 170 N. Y. 109; 62 N. E. 1073.

be heard in his own defence, and of this right he shall not be deprived under the constitution and the laws of the state. But there is a very large and eminently respectable current of authority opposed to the foregoing doctrine.[1]

As a general rule, the insurer who issues what is known as an official bond is not, in the absence of express provisions in the policy to that effect, concluded by a decree or judgment obtained by the insurer against the " risk," unless the insurer has had its day in court, or consented thereto in advance. But administration bonds seem to form an exception to this rule, and the insurer issuing the same, in respect to its liability for the default of the "risk" therein named, seems to be classed with such insurers as issue bonds, providing that the " risk " therein named shall do a particular act.[2]

Whenever the insurer expressly provides in an administration bond that the " risk " shall do a certain act, then, in the absence of fraud or collusion, the insurer is bound by the judgment obtained against the " risk " in an action brought by the insured to recover damages by reason of the failure of the " risk " to do this particular act.[3]

It has been held that a judgment in favor of the " risk " in an action against the " risk " by such insured, for the same cause of action wherein a liability is sought to be enforced against the insurer, is a bar to any action for the same cause by the insured against the insurer. This for the reason that, if the question of the " risk's " liability to the insured had not been previously adjudicated, the insurer could have requested the " risk " to defend the suit of the insured against it, and then if the judgment had gone against it, this would have been conclusive against the " risk." [4] As has already been said, administration bonds seem to form an exception to the general rule that sureties on official bonds are not concluded by decrees, final orders or judgments

[1] Am. Bond. & Tr. Co. *v.* U. S. to the Use of Paynter, 23 D. C. 535.

[2] State *ex rel.* Sur. Co., 76 Mo. App. 227.

[3] *Idem.*

[4] See B. Roth Tool Co. *v.* New Amsterdam Cas. Co., 161 Fed. 709; C. C. A. 8th Cir.

against their principals, unless the sureties have had their day in court, or an opportunity to be heard in their own defence.

However, in some states the judgments in such cases, while held to be conclusive against the principal, are only *prima facie* evidence of the sureties' liability.[1]

It has been said that no insurer can successfully defend itself as against an alleged liability, under an administration bond issued by it, on the ground that the court appointing the "risk" to the position named in such bond, as that wherein the "risk" should faithfully perform all the duties of such position, had no jurisdiction to render the judgment.

Wherever it appears that an order of the court has been made, adjudging that the "risk" in administration bonds has certain money in his hands, which he fails to pay over on proper demand, it establishes actual loss and injury to the insured, which will entitle the latter to compel the insurer to make good, under its bond, the amount of such loss and injury.[2]

It has been held in a recent case that payment by the assignee of an amount found due upon a settlement is within the obligation of the policy conditioned for the faithful discharge of his duties as assignee. It was said that a judgment against an assignee in a suit to settle his accounts is conclusive as against the surety as to the amount due, though he had no notice of the proceedings.[3]

The appellate division of the New York Supreme Court (first department) recently made the following holding by a divided court, to wit: That a trustee in bankruptcy has capacity to sue the surety on the bond of a bankrupt's assignee for the benefit of creditors to recover a sum found to be due from the assignee upon a judicial accounting in the federal court brought by him when the trustee is unable to collect from the assignee after judgment against him.

[1] Preston *v.* Am. Sur. Co., 104 Md. 40; Am. Bond. & Tr. Co. to Use of Paynter, 23 D. C. 535.

[2] People *ex rel. v.* Am. Sur. Co. *v.* Anthony, 7 N. Y. App. Div. 132.

[3] Cohen *v.* Am. Sur. Co., 192 N. Y. 227; 84 N. E. 947.

Although an assignment for the benefit of creditors is avoided when the assignor subsequently goes into bankruptcy, his trustee, claiming the property under a decree of the federal court adjudging that the property be turned over, is not claiming in hostility to the assignment so as to discharge the surety of the assignee from liability.

As the assignee's bond was given when the Bankruptcy Act was in force, the surety was charged with knowledge that, on the bankruptcy of its principal, the jurisdiction of the estate would pass to the federal court, and that the principal might there account. Hence such contingency must be written as part of the obligation.[1]

In all cases involving guardians, administrators and other bonds of like nature, where the duty of the "risk" is to account before the court of competent jurisdiction for the money or property that comes into his hands by virtue of his trust, the insured issuing such bonds is bound by any judgment recovered against the "risk" by the insured, and no defence is open to it, in the absence of fraud and collusion between the "risk" and the insured.[2]

§ 260. **Discharge of Liability by Settlement with the Insured.** — As in other forms of guaranty insurance, recovery can only be had on an administration bond up to the amount named therein as the maximum of the insurer's liability. Whenever this amount has been once paid, all further liability under the bond ends, and the insurer is discharged.

The sureties' liability to the insured can never be greater than the liability of the "risk" to the insured.[3] In order to entitle the insured to indemnity, it is not necessary to prove a demand previously made on the surety for settlement.[4]

The surety on an administration bond may pay the amount for which it is liable to the insured as soon as such liability

[1] Cohen *v.* Am. Sur. Co., 192 N. Y. 227; 84 N. E. 947.

[2] Thomson *v.* Am. Sur. Co., 170 N. Y. 109; 62 N. E. 1073.

[3] Fid. & Dep. Co. *v.* Schelper, *et al.*, 37 Tex. Civ. App. 393; 83 S. W. 871.

[4] U. S. Fid. & Guar. Co. *v.* Davis, 2 Ga. App. 325; 58 S. E. 777.

is found to exist, without waiting for judgment to be rendered in favor of the insured against the "risk."[1]

An action cannot be maintained against a surety on an executor's bond until the liability of the executor to make payment has been duly established and he has failed to pay the same.[2] As a general rule, under administration bonds, the insured may recover, in addition to the direct loss occasioned by the fraudulent acts of the "risk," his own personal costs and expenses.[3] Where a breach of the conditions of an administration bond is proved by the insured in an action thereon, the latter is entitled to at least nominal damages.[4]

CHAPTER XXI

STATUTORY INSURANCE BONDS

§ 261. **Statutory Insurance Bonds — General Remarks thereon.** — The second great class of judicial insurance contracts may be termed "statutory insurance bonds." The

[1] Howe *v.* White, *et al.*, 162 Ind. 74; 69 N. E. 684; Am. Sur. Co. *v.* Wood, 2 Ga. App. 641; 58 S. E. 1116.

[2] Garvey *v.* U. S. Fid. & Guar. Co., *et al.*, 79 N. Y. Sup. 337; 77 App. Div. 391.

[3] Anderson, *et al. v.* F. & D. Co., 100 Ga. 789; 28 S. E. 463; Morgan, *et al. v.* Fid. & Dep. Co., 101 Ga. 389; 28 S. E. 851. See generally relative to basis of settlement of loss by the insurer with the insured the following cases: Abrams *v.* U. S. Fid. & Guar. Co., 127 Wis. 579; 106 N. W. 1091; Lahn *v.* Sullivan, 101 N. Y. Sup. 920; 116 App. Div. 669; State *v.* Bergfield, 108 Mo. 631; Garvey *v.* U. S. Fid. & Guar. Co., *et al.*, 79 N. Y. Sup. 337; 77 App. Div. 391; Carpenter *v.* U. S. Fid. & Guar. Co., 123 Wis. 209; 101 N. W. 404; Fid. & Dep. Co. of Md. *v.* Nisbet, 119 Ga. 316; 46 S. E. 444; Frazer, etc. *v.* Frazer, etc., 25 Ky. L. Rep. 473; Wilson's Ass. *v.* Louisville Nat. Bank Co., 25 Ky. L. Rep. 1065; Fid. & Dep. Co. *v.* Schelper, *et al.*, 37 Tex. Civ. App. 393; 83 S. W. 871; Garvey *v.* U. S. Fid. & Guar. Co., 79 N. Y. Sup. 337; 77 App. Div. 391; Bamberger *v.* Am. Sur. Co., 96 N. Y. Sup. 665; 48 Misc. 221; Am. Sur. Co. *v.* Pratt, 67 Kan., 294; 72 Pac. 775; Cohen *v.* Am. Sur. Co., 123 N. Y. App. Div. 519.

[4] Thomson *v.* Am. Sur. Co., 170 N. Y. 109; 62 N. E. 1073; Cohen *v.* Am. Sur. Co. N. Y., 84 N. E. 947.

basis for such a classification, under the general head of judicial insurance, lies in the fact that, as a general rule, all bonds given in the course of litigation in the courts are usually required by statute. Insurance bonds of this character have by popular usage acquired certain more specific names, such as "appeal," "cost," "removal," "attachment," "injunction," "replevin," "indemnity bonds," etc. Besides, there are other bonds given out of court but pursuant to statutory requirement, such as, for example, "excise bonds," which are quasi-public in their nature and are classified as statutory insurance bonds. The right of the courts to accept such bonds is clearly established both by statutory enactment and the decisions relating thereto.[1] That the issuing of such bonds for a compensation constitutes the transaction of the business of insurance is equally well established.[2]

§ 262. **Nature and Purpose of Statutory Bonds.** — It is not the office of statutory insurance bonds to show in detail the nature of the liability thereby assumed by the insurer issuing the same. The only object of setting forth the scope of liability thereunder is to limit and define in a general way the extent of the obligations assumed by the obligors therein named. The policy itself is purely statutory and relates exclusively to the action or proceeding wherein it is given. It is issued solely by way of furnishing indemnity in that particular action, and any claim of any other or different liability would be wholly without foundation. For this reason the liability

[1] See Indust. & Gen. Tr. Co. *v.* Tod, 56 App. Div. N. Y. 39; Haines *v.* Am. Sur. Co., *et al.*, 73 N. Y. Sup. 293; N. Y. Co. Nat. Bank *v.* Am. Sur. Co., 69 N. Y. App. Div. 153; affirmed in 175 N. Y. 54; Markoe *v.* Am. Sur. Co., 44 App. Div. 285; as affirmed in 167 N. Y. 602; City Tr. Safe Dep. & Sur. Co. *v.* F. & C. Co., 58 N. Y. App. Div. 18, as affirmed in 171 N. Y. 666; 64 N. E. 1119.

[2] See Indust. & Gen. Tr. Co. *v.* Tod, *et al.*, 56 App. Div. N. Y. 39; People *ex rel.* Nat. Sur. Co. *v.* Feitner, 166 N. Y. 129; 59 N. E. 731; Am. Sur. Co. *v.* Thurber, 21 N. Y. St. Rep. 459; Fid. & Dep. Co. *v.* Singer, 50 Atl. 518; 94 Md. 124; Hicks *v.* Trustees of Village of Perry, Mich. ; 114 N. W. 682.

of the insurer is extinguished whenever that of the "risk" to the insured in such action is satisfied.[1]

§ 263. **Validity of Statutory Bonds.** — The general subject of the invalidity of that form of statutory bonds known as "excise" was considered at some length in Lyman *v.* Brucker, *et al.*[2] It was there held that an excise bond which provided in terms of the statute that an applicant for liquor tax certificate should not violate any conditions of the provisions of the liquor tax law, and in addition, "or any act amendatory thereof or supplemental thereto," is to be deemed to refer only to such amendments as were in force when the bond was executed, and in this view a "surety company" which signs it without knowledge of its contents cannot, after it has been accepted as a valid security, attack its validity upon the ground that it is more burdensome to them than the statute requires. The court, in its opinion in this case, observed that "a strict and technical conformity to the statute is not essential to the validity of such bonds. If they conform substantially to the form prescribed, it is sufficient; neither is it any objection to them that they are broader in their terms than is required by the statute, as long as it does not entirely amount to a breach of the rights of the surety company issuing the same. Assuming, then, that the bond does conform in all respects to the requirements of the statute, the 'surety company,' after having presented the bond to the excise commissioner as a lawful and valid security, who accepted it and who upon the strength of the security granted the required liquor tax certificate to the 'risk,' who has received the rights and benefits therefrom, then neither he

[1] See Feinberg *v.* Am. Sur. Co., 33 N. Y. Misc. Rep. 458; Moore *v.* Hanscom, Tex. ; 106 S. W. 876; Fid. & Dep. Co. of Md. *v.* Schelper, *et al.*, 37 Tex. Civ. App. 393; 83 S. W. 870; Hollister *v.* U. S. Fid. & Guar. Co., 84 Minn. 251; 87 N. W. 776; Lyman *v.* Shenandoah Social Club, 39 N. Y. App. Div. 459; 51 N. Y. Sup. 372; Lyman *v.* R. T. Ins. Co., 37 N. Y. App. Div. 234; 55 N. Y. Sup. 770; Lyman *v.* B. G. H. Co., 33 N. Y. App. Div. 130; 53 N. Y. Sup. 347; Lyman *v.* Gramercy Club, 28 N. Y. App. Div. 30; 50 N. Y. Sup. 1004.

[2] 26 N. Y. Misc. Rep. 594.

nor the 'surety company' ought to be permitted to escape liability because the bond does not conform to the exact language of the statute; neither should the court, upon technical grounds, aid them in escaping the consequences of a plain violation of its conditions. The parties who execute such bonds know or should have known the contents thereof when they have executed it, and if the language thereof was in the least prejudicial to them, they should have refused to sign it or have applied to the court to have it amended. . . . The parties to the bond, however, may waive any statutory rights with respect to applying to the court to have the same amended, and if they do so, and neglect to institute such proceedings to have the bond amended until an action is brought upon it, knowing that the 'risk' has obtained rights and privileges upon the faith and strength of it, they are estopped from questioning its validity. It would be unjust under the circumstances to permit them to repudiate their obligation."

There has been in times past an inclination on the part of some courts to declare the giving of counter-indemnity to the insurer issuing bail bonds to be contrary to public policy. Such a holding as is here referred to is not generally supported by the more recent authorities.[1] But where the prosecutor of an accused person has become bail for the latter and has given an indemnifying bond, he cannot, it is said, recover thereon upon the forfeiture of his recognizance by the accused. This for the reason that such a recovery would be contrary to public policy.[2]

§ 264. **Consideration for Statutory Bond.** — As a general rule, the actual acceptance by the proper authorities of a bond furnished pursuant to statute, coupled with the attendant advantage to the "risk" and the change of legal position on

[1] Flynn *v.* Union Sur. & Guar. Co., 61 N. Y. App. Div. 170; 70 N. Y. Sup. 403; Mayne *v.* Fid. & Dep. Co. of Md., 198 Pa. St. 490; 48 Atl. Rep. 469.

[2] Mayne *v.* Fid. & Dep. Co., 8 Penn. Dist. Ct. 711; see generally Bubb, *et al.* *v.* Am. Bond. & Tr. Co., 30 Pittsburg L. J. 361; Hicks *v.* Trustees of Village of Perry, Mich. ; 114 N. W. 682.

the part of the insured named in such statutory bond, is in itself a valid consideration for the issuing of the bond.[1] Outside of these the payment of a premium by the "risk" or the insured to the insurer will, of course, constitute a valid consideration for the issuance of the bond.

§ 265. **Construction of Statutory Bonds.** — What has already been said upon the general subject of construction of judicial insurance bonds[2] is, of course, equally applicable here. In addition to what has already been said there, the following may be added:

The character of the instrument furnished by these companies as contracts of insurance seems to have been frequently lost sight of in all matters of construction, and the bonds of private sureties and corporate insurers have been erroneously treated as instruments of essentially the same character and nature.[3] To justify non-existence of liability on such bonds, the language defining the said liability must be so clear and explicit as to admit of no other construction than the scope of liability contended for by the insured.[4]

Again it should be noted that statutory bonds executed in the form prescribed by the statute are to be construed as though the law requiring and regulating them was written on them as respects the material rights and obligations of the insured, the insurer and the "risk."[5]

§ 266. **Parties to Statutory Bonds — General Remarks concerning.** — The obligation of the insurer under a statutory insurance bond is, with respect to the right of enforcement thereof, personal to the insured.[6] Inasmuch as the "risk"

[1] Fid. & Dep. Co. *v.* Bowen, *et al.*, 123 Ia. 356; 98 N. W. 897; see also Mossein *v.* Em. St. Sur. Co., 89 N. Y. Sup. 843; 97 App. Div. 23.

[2] See *ante*, § 226.

[3] See Lyman *v.* Kurtz, *et al.*, 166 N. Y. 274; Fid. & Dep. Co. *v.* Singer, 94 Md. 124; 50 Atl. 518.

[4] See Feinberg *v.* Am. Sur. Co., 33 N. Y. Misc. Rep. 458; Am. Sur. Co., *et al. v.* Boyle, *et al.*, 65 Ohio 547; 63 N. E. 73; Am. Sur. Co. *v.* Koen, Tex. App. ; 107 S. W. 938.

[5] Zellars *v.* Nat. Sur. Co., Mo. ; 108 S. W. 548; Cohen *v.* Am. Sur. Co., 123 App. Div. 519; Guardian Tr. Co. *v.* Peabody, 107 N. Y. Sup. 515, 518.

[6] Fid. & Dep. Co. *v.* Singer, 94 Md. 124; 50 Atl. 518.

named in a statutory insurance bond usually executes the same in company with the insurer, he has the right to be made a party defendant with the latter in any action brought thereon by the insured or his assignees.[1] There is particular reason for extending to the "risk" this right where he has been notified by the insurer to defend the action, and will be concluded by the result.[2]

§ 267. **Insurable Interest in Statutory Bonds.** — The same necessity for the possession by the insured of an insurable interest in a statutory bond as a condition precedent to the enforcement of liability thereunder exists in the case of statutory bonds to the same extent as it does in fidelity and contract insurance. The general subject of insurable interest under statutory bonds is well considered by the Maryland court of appeals in the case of Fidelity and Deposit Company *v.* Singer, *et al.*[3] In this case a debtor and his trustee for the benefit of creditors were named as the insured in their individual capacity in a replevin bond furnished by the surety company at the request of the " risk " named in such bond. The " risk " in this case was a seller of goods who replevied goods previously sold by him to such debtor, the trustee for creditors having refused to accept the goods so sold after the debtor's assignment to him. The court held that the debtor and his trustee had no insurable interest in the goods so sold as would sustain an action by them to recover on the replevin bond. This latter case was brought in the names of the debtor and his trustee for the use of the latter in his representative capacity. The court in its opinion in this case spoke as follows:

[1] Feinberg *v.* Am. Sur. Co., 33 N. Y. Misc. 458; Matter of Mason, 12 N. Y. Misc. Rep. 77; Lyman *v.* F. & C. Co., 65 N. Y. App. Div. 327.

[2] See generally on parties: Lyman *v.* Roch. Tit. & Sur. Co., *et al.*, 37 N. Y. App. Div. 234; City Tr. Safe Dep. & Sur. Co. *v.* Am. Brewing Co., 174 N. Y. 486; 67 N. E. 62; Eccles *v.* U. S. Fid. & Guar. Co., 72 Neb. 439; 100 N. W. 942; Columbia Bank *v.* Am. Sur. Co., 82 N. Y. Sup. 1054; 84 App. Div. 487; Hollister *v.* U. S Fid. & Guar. Co., 84 Minn. 251.

[3] 94 Md. 124; 50 Atl. 518.

"The contract of a surety on a replevin bond is a contract of indemnity and nothing more.[1] The surety undertakes to hold the obligee named in the bond harmless; that is to say, that the goods are returned or their value paid to the obligee by the principal in the bond if the replevin suit be not prosecuted with effect, and if the obligee be entitled to the goods or to their value. If the obligee has no interest in or right to the possession of the goods, a deprivation of them or of the possession of them can do him no substantial injury. A surety is never bound beyond the terms of his contract, and this means not only that he is not liable for a larger undertaking than he has assumed, but that he is not answerable to any other person than the one with whom the contract was made. A replevin bond is not, like a trustee's or executor's bond, payable to the state for the use of any one who may be or may become interested in the fund or in the estate; but it is payable to the defendant in the replevin suit. Whilst a suit on it may be entered by the obligee to the use of another person, the obvious measure of the sum recoverable is the extent of the damages which the obligee might exact, and is not the amount which the equitable plaintiff, who is not a party to the bond, has sustained. If this were not so, a person not indemnified by the bond, because not named as obligee, could not recover against the surety on the bond a sum in excess of that which the obligee himself could recover. The surety would thus be held bound to a person with whom he did not contract, and in addition he would be made liable to the latter in a larger amount than to the person with whom he did contract. This cannot be, and hence it is clear that the extent of the right which the person to whose use the suit on the replevin bond is brought may have in the property replevied, is not the measure of the surety's liability, but the extent of the right of the obligee in that property is the true measure of that liability. The assignee of the bond can have no greater rights than the assignor had."[2]

[1] Bell *v.* Worthington, 3 Gill & J. 247.

[2] See also on the general subject of insurable interest the following cases: Columbia Bank *v.* Am. Sur. Co., 82 N. Y. Sup. 1054; 84 App. Div. 487; Dudley, *et al.* *v.* State *ex rel.* Roe, *et al.*, Ind. ; 81 N. E. 89; Cullinan *v.* Kuch, 177 N. Y. Rep. 303; 69 N. E. 597; Mossein *v.* Em. St. Sur. Co., 89 N. Y. Sup. 843; 97 App. Div. 230; McCormick *v.* Nat. Sur. Co., 134 Cal. 510; 66 Pac. 741; Cohen *v.* Am. Sur. Co., 192 N. Y. 227; 84 N. E. 947; Robert *v.* Secur. Tr. Co., 121 Fed. 460; Eccles *v.* U. S. Fid. & Guar. Co., 72 Neb. 438; Hollister *v.* U. S. Fid. & Guar. Co., 84 Minn. 251; 87 N. W. 766; Sachs *v.* Am. Sur. Co., 72 N. Y. App. Div. 60; 76 N. Y. Sup. 335; Cullinan *v.* Kuch, 177 N. Y. 303; 69 N. E. 597.

§ 268. **Execution of the Bond.** — Frequent attempts have been made to defeat actions to enforce the liability under statutory bonds by denying that there ever was any due execution of the bond sued on. Usually all such attempts are frustrated by an extended application of the doctrine of estoppel. This on the principle that where the insured has changed its legal position in reliance upon the assumption that the bond was lawfully executed, under such circumstances the insurer is estopped to deny the fact of its due execution.[1]

However, it has been held that where the insured has knowledge that the agent of the insurer has no authority to execute a bond without the approval of another officer of the insured, then in such case the principle of estoppel does not apply, and the insurer is not liable under the bond.[2]

It was held in a California case[3] that where a bond was given to procure an appeal from a justice of the peace, and the same was produced at the trial by the justice's deputy clerk as having been found among the papers of the justice, and the justice himself declared the bond had been filed, such facts justified a finding that the bond had been delivered.

It sometimes becomes an interesting question to determine whether a corporation not engaged in the business of furnishing bonds for compensation has the authority to execute the statutory bond in behalf of some designated "risk." The Supreme Court of Texas has held that a corporation whose charter provides that its principal business shall be buying

[1] U. S. Fid. & Guar. Co. *v.* Murphy, Ga. ; 60 S. E. 831; Fid. & Dep. Co. of Md. *v.* Bowen, *et al.*, 123 Ia. 356; 98 N. W. 897; Brady *v.* Onffroy, 37 Wash. 483; 79 Pac. 1004; Nolan *v.* Fid. & Dep. Co., 2 Cal. App. 1; *In re* Am. Fid. Co., 104 N. Y. Sup. 711; 54 Misc. 357; Olds, *et al.* *v.* City Tr. Safe Dep. & Sur. Co., 185 Mass. 500; 70 N. E. 822; U. S. Fid. & Guar. Co., *et al.* *v.* Ettenheimer, 70 Neb. 144; 97 N. W. 227.

[2] Cullinan *v.* Bowker, 88 N. Y. 170; Fid. & Dep. Co. *v.* Bowen, *et al.*, 123 Ia. 356; 98 N. W. 897; Carrau *v.* U. S. Fid. & Guar. Co., Wash. ; 92 Pac. 424; San Francisco Sulphur Co. *v.* Ætna Indemn. Co., Cal. ; 93 Pac. 888.

[3] Nolan *v.* Fid. & Dep. Co., 2 Cal. App. 1; 82 Pac. 1119.

and selling liquors, etc., at wholesale and retail, has implied power to sign a saloon-keeper's bond as surety though no express or implied contract exists between them that he will purchase liquors of the corporation, since becoming surety for a possible customer is a proper and usual means of promoting its business.[1]

§ 269. **Attachment and Duration of Liability.** — As a general rule, all statutory bonds, as their name implies, are creatures of statute, and their continued existence as well as operation is largely controlled thereby.[2] In general, the period of the insurer's liability under such bonds is coextensive with that of the "risk" to the insured named therein.[3]

In support of the general proposition just stated, attention is called to the case of Lyman *v.* Cheever and United States Guaranty Company,[4] where, in construing an excise bond conditioned, among other things, upon the "risk's" not violating any of the provisions of the liquor tax law, while the business, for the transaction of which he had been given a permit by the state, should be carried on, it was observed that "the permit was surrendered twenty days prior to the alleged violation complained of. From the date of its surrender it was no longer held by Cheever (the "risk") as a permit under which he could continue to traffic in liquor. All fines and penalties theretofore accruing during the time the permit was held by Cheever, the surety was bound to pay. . . . Liability under the bond continued under the provision of the statute for one year, the time for which the permit was issued, or in case of its surrender previous to that time during the time for which it is held. Fines and penalties theretofore accruing might be recovered under the bond, but none for offences thereafter committed."[5] Under an Iowa statute,

[1] Munoz, *et al. v.* Brossell, *et al.*, Tex. , ; 108 S. W. 417.

[2] Markoe *v.* Am. Sur. Co., 44 App. Div. N. Y. 285; 60 N. Y. Sup. 674; 167 N. Y. 602; 60 N. E. 1115.

[3] *Idem.;* 167 N. Y. 602; Fid. & Dep. Co. *v.* Schelper, *et. al.*, 37 Tex. Civ. App. 393; 83 S. W. 871.

[4] 168 N. Y. 43; 60 N. E. 1047.

[5] See also Lyman *v.* Siebert, *et al.*, 31 N. Y. Misc. 285; People *v.* Lyman, 156 N. Y. 407; 50 N. E. 1112.

authorizing the cancellation of a liquor bond on the application of the insurer, it was held that inasmuch as the bond did not specify any specific term, it would be regarded as a continuing bond. As such it would not be subject to revocation during any year with reference to which it had taken effect, but the insurer by revoking the bond prior to the beginning of a new year and giving notice thereof to the approving officers would thereby release itself from all liability thereafter.[1]

Bonds given on successive appeals are cumulative and the giving of the second does not discharge the first. The obligee may proceed upon either or both until the insured has obtained satisfaction of his judgment. They are separate contracts given to secure the payment of the same debt, and until that debt is liquidated, the obligors in either are not advantaged by the fact that the insured has brought an action upon the other.

The general rule applicable to and questions relative to attachment and duration of liability under statutory bonds is that the recitals therein are conclusive against the insurer, whether the undertaking is a statutory or common law bond.[2]

§ 270. **Scope of Liability.** — While all statutory bonds are creatures of statute, and their existence as well as operation is controlled thereby, nevertheless substantial requirement with such statutes is all that is required in such cases. Not infrequently, if there is a lack of conformity to statutory requirements, they will be upheld as common law obligations. The present tendency of the courts is towards adopting an intermediate position, neither strict nor liberal in the construction of a "surety company's" liability under statutory insurance bonds.[3] The limitation of liability in the policy by

[1] Fid. & Dep. Co. *v.* Jenness, Ia. ; 116 N. W 709.

[2] Bailey *v.* Ætna Indemn. Co., Cal. ; 91 Pac. 46; Lyman *v.* Gramercy Club, 39 N. Y. App. Div. 661; 57 N. Y. Sup. 376; Lyman *v.* Brucker, 26 N. Y. Misc. 594; 56 N. Y. Sup. 567; People *ex rel.* Meskin *v.* Eickman, 63 Hun. 209; 18 N. Y. Sup. 654.

[3] See Am. Sur. Co. *v.* Haynes, 91 Fed. 90; Markoe *v.* Am. Sur.

the insurer fixes its extent. If there is no authority in law for the proceedings had wherein the bond is given, there can be none for taking such bond, and therefore the same is void.

In general, the rule may be safely laid down that where parties enter into any obligation in pursuance of a statute and for the purpose of procuring some benefit conditioned upon the assumption of such obligation, they will necessarily be presumed to have intended to have come under all the conditions expressed in their contract which were required by statute.[1]

Attention is first called to a case bearing upon the scope of liability under appeal bonds issued by surety companies. Reference is had to that of Markoe *v.* American Surety Company.[2] This was an action where the insured named in an appeal bond had obtained a judgment of divorce and for alimony against her husband. To enforce this alimony judgment, the plaintiff subsequently brought an equitable action to compel the application of certain trust funds to the payment thereof. In this she was successful, and her husband (the "risk" named in the appeal bond subsequently issued by a "surety company") appealed to the court of appeals, in which action the bond in controversy was given. The judgment was affirmed by the court of appeals, and an action upon the appeal bond was thereafter commenced. It appeared that notwithstanding the giving of the appeal bond, the "surety company," pending the appeal, collected all the income which was earned by the trust. It appeared also that prior to the commencement of the action the "risk" named in the bond paid to the insured therein named all the costs in the action. Thus the entire obligation of the "risk" on the appeal bond was fulfilled. Commenting upon the claims of the insured as to the "surety company's" liability on the appeal bond, the court spoke as follows:

Co., 53 N. Y. App. Div. 285; 60 N. Y. Sup. 674; 168 N. Y. 539; 60 N. E. 1115; Lesster *v.* Law. Sur. Co., 50 N. Y. App. Div. 181; State *ex rel.* Owens *v.* Fraser, 65 S. W. 569.

[1] Lyman *v.* City Tr. Safe Dep. & Sur. Co., *et al.*, 48 N. Y. App. Div. 633; 166 N. Y. 274; 59 N. E. 903.

[2] 44 N. Y. App. Div. 285.

"It may well be asked, under these circumstances, what her complaint is in the present action. Avowedly it is to compel the surety to pay the alimony awarded to her in the original divorce judgment, less the sums received from the trust fund under the decree in the equity action. But the surety made no such contract. Its undertaking was not upon any appeal taken in the divorce case. It had nothing whatever to do with that case. Its undertaking was statutory, and related solely to the equity action which was brought in aid of the original alimony decree. There was no judgment in this equity action requiring either the husband or the trustee personally to pay the sums awarded to the plaintiff as alimony in the divorce action. The judgment in the equity action simply decreed a lien in the plaintiff's favor upon the trust fund to the extent of her alimony judgment, and directed the payment to her of all the trust income which should be required to satisfy that alimony judgment. Not a dollar was required to be paid by this equity decree save the trust income. That that trust income should be paid to the plaintiff was, therefore, the defendant's sole undertaking. The claim of any other or different liability is wholly without foundation. It was to indemnify itself against that particular liability, and against no other, that this 'surety company' took security from the applicants in the equity action. That liability having been extinguished by the satisfaction of the equity judgment, this security was properly returned to the appellants here."

It is not the purpose of a statutory bond, given for the purpose of procuring an appeal, to show the nature and scope of such appeal, and the only object of referring to the judgment therein is to enable it to be identified as the subject of the instrument. When this is accomplished its office is performed.[1]

Turning now to the question of the scope of liability under excise bonds, attention is called to the case of Lyman *v.* Kurtz, *et al.*[2] Here the "surety company" issuing an excise bond containing a condition to the effect that the "risk" would not permit gambling upon the premises where the liquor was to be sold, was held not to be relieved from liability for a breach of that condition because of a subsequent provision in the bond that it was to cover every violation of the liquor tax

[1] Markoe *v.* Am. Sur. Co., 25 N. Y. Misc. 127; 53 App. Div. 285; 167 N. Y. 602.

[2] 166 N. Y. 274; 59 N. E. 903.

law, which at the time the bond was executed did not prohibit gambling, inasmuch as the parties must have intended that the bond should cover the case of gambling upon the premises as well as any violation of the provisions of the law itself. In this case it was argued by counsel for the "surety company" that the general terms of the insurer's obligation under the bond were qualified by the language which concluded the clause containing the conditions of the obligation, and that thereby the bond was so restricted as only "to cover every violation of the liquor tax law and all fines and penalties incurred or imposed thereunder." It was argued that if the insurer's liability under the bond is not to be extended beyond the strict terms of the contract, then that is confined to violations of the liquor tax law simply, and does not comprehend the condition, for breach of which suit was brought on the bond by the insured. The court, in passing upon the question, spoke as follows:

"The rule of law invoked by the 'surety company' depends for its obligation upon the ascertainment of the intention of the parties to the instrument, which is to be reached upon the consideration of the whole thereof and that in the light of the circumstances under which it was made. If it is manifest that it must have been their intention that their obligations should cover the case of gambling upon the premises as well as a violation of the liquor tax law provisions, then the subsequent language which is depended upon to qualify the more general terms of the contract will be inoperative to effect such a result and may be regarded as surplusage, or perhaps as an unnecessary repetition of the principal feature of the obligation and for the sake of emphasis. While the liquor tax law did not at that time prohibit gambling, nevertheless the legislature required, as a condition preceding the issuing of the certificate, that a bond should be issued to the people that the applicant would not permit any gambling to be done on the place designated by the tax certificate in which the traffic in liquor was to be carried on, in addition to agreeing not to violate any of the provisions of the law itself. The object of the legislature undoubtedly was that the place where the liquor business was to be carried on should not be characterized by unlawful or disorderly conduct, and to secure this end inserted the requirements in question. The parties obligating themselves to the state in pursuance

of the statutory provisions and for the purpose of procuring the issuing of the certificates are necessarily to be presumed to have intended to have come under all the conditions expressed in their contract which were required by the statute."

In a recent federal case the court had occasion to construe a distiller's "annual bond" given pursuant to statute, conditioned upon the "risk" therein named faithfully complying with all the provisions of law relating to the duties and business of distillers and paying all penalties incurred or fines imposed on him for a violation of any of the provisions of the statute in such case made and provided. It was held that the bond did not cover the payment of taxes on distilled spirits, which the "risk" had deposited in a bonded warehouse, nor did it require the payment of taxes for which he had given a prior "warehouse bond" which had been accepted by the government.[1]

[1] U. S. *v.* Nat. Sur. Co., 112 Fed. 336. See generally as to scope of liability under a statutory insurance bond the following cases: Markoe *v.* Am. Sur. Co., 60 N. Y. Sup. 674; 53 N. Y. App. Div. 258; 167 N. Y. 602; 60 N. E. 1115; Vent, *et al.* *v.* Duluth Tr. Co., 80 N. W. 640; Fid. & Dep. Co. *v.* Beck, 12 App. Cas. D. C. 237; Kansas City *v.* Am. Sur. Co., 71 Mo. App. 315; Wood & Co. *v.* Am. Sur. Co., 25 Misc. N. Y. 198; Borden *v.* Am. Sur. Co., 159 Pa. St. 465; 28 Atl. 301; Kleiner *v.* Fid. & Dep. Co., 67 N. Y. Sup. 216; Numbers *v.* Rocky Mountain Bell Tel. Co., 7 Ida. 408; 63 Pac. 381; on admiralty bonds, see The Bencliff, 158 Fed. 377; official bonds, Scot *v.* Commonwealth for Use of, etc., 29 Ky. L. Rep. 571; 93 S. W. 668; U. S. Fid. & Guar. Co. *v.* Milestead, Ky. ; 109 S. W. 875; jail liberties, McLean *v.* Fid. & Dep. Co., 107 N. Y. Sup. 907; injunction, White Pine Lumber Co. *v.* Ætna Indemn. Co., 42 Wash. 569; 85 Pac. 52; Fid. & Dep. Co. *v.* Tinsley, 30 Ky. L. Rep. 1095; 100 S. W. 272; Nat. Soc. of U. S. Daughters of 1812 *v.* Am. Sur. Co. of N. Y., 107 N. Y. Sup. 820; replevin, Freeman *v.* U. S. Fid. & Guar. Co., 87 N. Y. Sup. 493; 43 Misc. 364; Rogers *v.* U. S. Fid. & Guar. Co., 74 N. Y. Sup. 203; Katz *v.* Am. Bond. & Tr. Co., 86 Minn. 168; 90 N. W. 376; supersedeas bond, U. S. Fid. & Guar. Co. *v.* Boyd, 29 Ky. L. Rep. 598; 94 S. W. 35; appeal, Tyng *v.* Am. Sur. Co., 174 N. Y. Ct. of App. 166; 66 N. E. 668; Baer *v.* Fid. & Dep. Co., 130 Fed. 974; Doon *v.* Am. Sur. Co., 97 N. Y. Sup. 270; 110 App. Div. 215; forthcoming bond, Fid. & Dep. Co. *v.* B. F. Sturtevant Co., 86 Miss. 509; 38 Sou. 783; bankruptcy, Nixon, *et al.* *v.* Fid. & Dep. Co., 150 Fed. 574; attachment, Am. Sur. Co. *v.* Campbell & Zell Co., 138 Fed. 531; Tyng *v.* Am. Sur. Co., 174 N. Y. 166; 12 Bedell 835; U. S. Fid. & Guar. Co. *v.* Howes, *et al.*,

A consideration of the scope of liability under excise liquor license bonds presents many features not to be found in other statutory bonds. Such bonds are an assurance that the business of a licensed dealer in liquors will be conducted in the manner prescribed by the liquor tax law and not otherwise; that the privilege of trafficking in liquor will not be abused, and that all of the requirements of the law will be observed in the conduct of the business. It is a contract with the state touching the conduct of the business.[1]

Ky. ; 109 S. W. 343; McCormick *v.* Nat. Sur. Co., 134 Cal. 510; 66 Pac. 741; probate, Williams *v.* Fid. & Dep. Co., Col. ; 93 Pac. 1119; Held *v.* Burke, *et al.*, 83 App. Div. 509; sheriff's bond, Sloan *v.* Nat. Sur. Co., 97 N. Y. Sup. 561; 111 App. Div. 94; State *ex rel.* Kennan *v.* Fid. & Dep. Co., 94 Mo. App. 184; 67 S. W. 958; N. Y. County Bank *v.* Am. Sur. Co., 69 App. Div. 153; MacDonald *v.* City Tr. Safe Dep. & Sur. Co., 80 N. Y. Sup. 405; 39 Misc. 552; Fowler *v.* State, 99 Md. 594; 58 Atl. 444; liquor, Cullinan *v.* Furthmann, *et al.*, 75 N. Y. Sup. 90; 70 App. Div. 110; People *ex rel.* Hill, *et al. v.* Union Sur. Co., 105 N. Y. Sup. 72; 120 App. Div. 655; Cullinan *v.* Bowker, *et al.*, 82 N. Y. Sup. 707; 40 Misc. 439; distiller's, U. S. *v.* Nat. Sur. Co., 157 Fed. 174; see generally Am. Bond. Co. *v.* Hughes, *et al.*, Neb. ; 107 N. W. 591; U. S. Fid. & Guar. Co. *v.* Rieck, Neb. ; 107 N. W. 389; O'Brien *v.* Am. Sur. Co., 85 N. Y. Sup. 316; 88 App. Div. 526; Hawkins, *et al. v.* Mapes Reeves Cons. Co., *et al.*, 81 N. Y. Sup. 794; 82 App. Div. 72; Esselysteyn *v.* Union Sur. & Guar. Co., 81 N. Y. Sup. 532; 82 App. Div. 474; Mossein *v.* Em. St. Sur. Co., 102 N. Y. Sup. 1013; 117 App. Div. 820; State *v.* Donohoe, *et al.*, 5 Pennewill, Del., 278; 63 Atl. 643; Collins, *et al. v.* Huffman, Wash. ; 93 Pac. 22; Barley *v.* Ætna Indemn. Co., Cal. ; 91 Pac. 416; Singer, *et al. v.* Fid. & Dep. Co. of Md., 54 Atl. 63; 96 Md. 221; Am. Bond. Co. of Baltimore *v.* Ensey, same *v.* Chandlee, 65 Atl. 921; Sparrow *v.* E. Bement & Sons, 146 Mich. 326; Culver *v.* Fid. & Dep. Co. of Md., 149 Mich. 630; 113 N. W. 9.

[1] Cullinan *v.* Burkhard, *et al.*, 86 N. Y. Sup. 1003; see also *in re* liquor bonds the following cases: Lyman *v.* Fid. & Dep. Co., *et al.*, 49 N. Y. App. Div. 630; 166 N. Y. 410; Lyman *v.* R. T. Ins. Co., 37 N. Y. App. Div. 234; Lyman *v.* Shenandoah Social Club, 39 N. Y. App. Div. 459; Lyman *v.* Cheever, 168 N. Y. 43; 60 N. E. 1047; Lyman *v.* Oussani, 65 N. Y. App. Div. 27; 72 N. Y. Sup. 498; Lyman *v.* Kurtz, 166 N. Y. 274; 59 N. E. 903; Lyman *v.* Mead, 56 N. Y. App. Div. 582; 67 N. Y. Sup. 254; Cullinan *v.* Parker, 84 App. Div. 296; 82 N. Y. Sup. 827; 177 N. Y. 573; Cullinan *v.* F. & C. Co., 84 App. Div. 292; 82 N. Y. Sup. 695; 177 N. Y. 574; *Idem.*, 84 N. Y. App. Div. 296; 82 N. Y. Sup. 827; 177 N. Y. 573; Cullinan *v.* F. & C. Co., 83 N. Y. Sup. 969; 41 N. Y.

§ 271. **Incidental Liability of the Insurer arising out of the Execution of Statutory Insurance Bonds.** — It was at one time thought that parties by merely joining in the execution of statutory insurance bonds might be held as joint trespassers with the "risk" in case the proceedings under which the alleged trespass occurred were vacated or annulled. But the later and more modern rule in such cases undoubtedly is that in every case the insurer issuing such bonds must actually participate in the trespass in order to be held liable as a joint trespasser with the "risk."[1]

Insurers should upon principle in the case of attachment bonds only be held to make good such direct and proximate damages as the insured may have sustained by being deprived of his property, or the use thereof, or by its loss or injury, together with the taxable costs and expenses incurred in relation to the attachment. It should not, in reason or in equity, be held liable under the policy for such collateral or consequential damages as could only be recovered against the "risk" by proof of malice, and want of probable cause;

Misc. 119; Cullinan *v.* Burkhard, 93 N. Y. App. Div. 31; 86 N. Y. Sup. 1003; Cullinan *v.* Kuch, 177 N. Y. 303; 69 N. E. 597; Cullinan *v.* Trolley Club, 65 App. Div. 202; 72 N. Y. Sup. 629; Cullinan *v.* Rorphiro, 93 N. Y. App. Div. 200; 87 N. Y. Sup. 570; Lyman *v.* Kane, 57 App. Div. 544; 67 N. Y. Sup. 1065; Lyman *v.* Siebert, 65 N. Y. Sup. 367; 31 N. Y. Misc. 285; Cullinan *v.* Furthmann, 70 N. Y. App. Div. 110; 75 N. Y. Sup. 90; Cullinan *v.* Criterion Club, 86 App. Div. 626; 83 N. Y. Sup. 1104; 39 Misc. 270; 79 N. Y. Sup. 482; Cullinan *v.* Kisselbrack, 43 N. Y. Misc. 1003; 87 N. Y. Sup. 1025; Shea *v.* F. & C. Co., 39 N. Y. Misc. 107; 78 N. Y. Sup. 892; 83 N. Y. App. Div. 305; 82 N. Y. Sup. 39; C. T. S. etc. Co. *v.* Am. Brewing Co., 88 App. Div. 383; 84 N. Y. Sup. 771; 181 N. Y. 285; 74 N. E. 948; Cullinan *v.* O'Connor, 100 N. Y. App. Div. 142; 91 N. Y. Sup. 628; Matter of Am. Fid. Co., 54 N. Y. Misc. 357; 104 N. Y. Sup. 711; Clement *v.* Belanger, 120 App. Div. 662; 105 N. Y. Sup. 537; People *ex rel.* *v.* United Sur. Co., 120 App. Div. 655; 105 N. Y. Sup. 72; Cullinan *v.* Furthmann, *et al.*, 187 N. Y. 160; 79 N. E. 1089.

[1] See Sonnentheil *v.* Tex. Guar. & Tr. Co., 30 S. W. 945 and 56 S. W. Rep. 143; Eldridge *v.* Fid. & Dep. Co., Tex. App. ; 63 S. W. Rep. 955.

such, for example, as loss of profits incident to the levy of the attachment, or injury to defendant's credit.[1]

Again, where a "surety company" was sued for wrongfully abetting a United States marshal in levying an attachment against third parties on the plaintiff's property, and it pleaded that its liability, if any, was that of a surety on the attachment bond, and that the marshal and attaching creditor had been acquitted of liability for such attachment in the United States circuit court, it was held that the plaintiff's demurrer thereto was properly overruled, since such judgment deprived the "surety company" of its contingent right as a surety to hold the attaching creditor liable on the bond, and was a bar to the action.[2]

§ 272. **Liability of the Insurer under Statutory Bonds. How Discharged?** — The insurer's liability may be discharged in any one of the following enumerated ways:

1st. By rescission or cancellation of the policy.
2d. By misrepresentation on the part of the insured.
3d. By concealment on the part of the insured.
4th. By breach of warranty on the part of the insured.
5th. By breach of conditions on the part of the insured.
6th. By settlement of loss.

§ 273. **Discharge of Liability by Rescission or Cancellation.** — As a general rule, in the absence of fraud, collusion, or material misrepresentation, there can be no rescission or cancellation of the statutory bond except where the same is authorized by statute or where the same is accomplished by consent of the parties. This rule is based upon sound public policy.[3]

[1] See L. Bucki & Son Lumber Co. *v.* Fid. & Dep. Co. of Md., 109 Fed. 393; per opinion Shelby, J., dissenting.

[2] Sonnentheil *v.* Tex. Guar. & Tr. Co., 23 Tex. App. 436; 56 S. W. 143; see also Sonnentheil *v.* Tex. Guar. & Tr. Co., 10 Tex. App. 274; 30 S. W. 945; Baumstein *v.* Am. Bond. & Tr. Co., 84 N. Y. Sup. 982; Plymouth Gold Mining Co. *v.* U. S. Fid. & Guar. Co., Mont. ; 88 Pac. 565; First Nat. Bank, *et al.* *v.* Fid. & Dep. Co., 106 Ill. 367; Johnston *v.* Caxton, *et al.*, 159 Fed. 70; Thomson *v.* Am. Sur. Co., 170 N. Y. 109; 62 N. E. 1073.

[3] See Siebert *v.* Millbank, 95 N. Y. App. Div. 566; 88 N. Y. Sup. 993; Rich & Bros. *v.* Fid. & Dep. Co., 126 Ga. 461; 55 S. E.

It is scarcely necessary to add, that even when there exists a statute expressly authorizing the revocation of a bond by the insurer, such revocation can only operate *in futuro* as far as relieving the insurer from liability thereunder is concerned.[1]

§ 274. **Discharge of Liability by Misrepresentations.** — The case of Lyman *v.* Schermerhorn, and the Fidelity and Deposit Company of Maryland[2] is a case of much value as bearing upon the question as to when the insurer upon a liquor tax bond, given upon application therefor by the "risk," is liable for false statements contained in such application. The facts therein were as follows: One Schermerhorn applied for a permit to sell liquors. In this application Schermerhorn falsely said that he had never been convicted of felony. Pursuant to the statutes of the state of New York, Schermerhorn had furnished to the state an excise bond executed by the Fidelity and Deposit Company of Maryland in the usual form. This bond recited that Schermerhorn was about to apply for a liquor tax certificate, and the condition of the bond was that if the liquor tax certificate applied for should be given unto Schermerhorn, the latter would not, while the business for which such liquor tax certificate was given should be carried on, violate any provisions of the liquor tax law. Inasmuch as Schermerhorn had been previously convicted of felony, no valid liquor tax certificate could be issued to him to traffic in liquors. He sold liquors, and a recovery was had against him to the full amount of the liquor traffic bond by reason of the fact that, as a person who had been previously convicted of felony, he had no legal right to traffic in liquors, or to be granted a liquor tax certificate. The New York court of appeals, in holding that the judgment so rendered against the "surety company" was void, spoke as follows:

336; Cullinan *v.* Kuch, 177 N. Y. 304; 69 N. E. 597; Am. Sur. Co. *v.* Campbell & Zell Co., 138 Fed. 531; Thomson *v.* Am. Sur. Co., 177 N. Y. 109; 62 N. E. 1073; Shea *v.* F. & C. Co., 83 N. Y. App. Div. 305; 82 N. Y. Sup. 39.

[1] Fid. & Dep. Co. *v.* Jenness, Ia. ; 116 N. W. 709.

[2] 167 N. Y. 113; 60 N. E. 324.

"If the surety had known when it executed the bond that Schermerhorn had been convicted of felony, then complicity with him in intending to violate the law, and in his subsequent violation of it by trafficking in liquors, would be a natural inference, and equal liability with him upon the bond would follow. But the surety did not know that Schermerhorn had been convicted of felony. It did not guarantee the truth of Schermerhorn's statement. The suretyship results, not from the surety's participation in the principal's wrong, but from the state's acceptance of it as right. The county treasurer had jurisdiction to pass upon the application, accept the bond, and issue the liquor tax certificate. As between the state and the surety, both acting in good faith, the bond had its inception and validity because the county treasurer acted within his jurisdiction in issuing the certificate. It is obvious that the state might never obtain knowledge that Schermerhorn's statement was false, or, obtaining it, might never act upon it, and thus as between the state and the surety both bond and certificate would both continue to be valid. So long as the state insists upon the validity of the bond, it acts upon the truth of the application and the validity of the certificate. Schermerhorn's traffic in liquor, here proved, was before the state asserted the falsity of the application and the invalidity of the certificate, and therefore as to the surety the liquor tax certificate still protected such traffic.

"Until either the state or the surety takes some action with notice to the other that it elects to withdraw from the relation each has in good faith assumed to the other, that relation continues in the sense and meaning in which it was originally assumed. When the state changes its position with regard to the certificate, and to the qualification of the certificate holder to traffic in liquors, while it may punish the latter because of his false statement and his sales while disqualified, it cannot punish its surety without convicting it of complicity with him. Such liability of the surety was not within the meaning or intent of the surety's obligation. The surety had no intent to give a bond for a convicted felon, and the estate had no intent to ask or receive such a bond. The bond was given and received as for a person not disqualified. The position of the surety is no worse than that of the state. The surety did not pass upon the application, the county treasurer did, and the bond would have had no life nor validity but for that officer's approval of the application; hence, when the state withdraws that approval and asserts that the certificate affords no protection to its holder, the bond which was given in consideration of such protection ceases to be supported by it. The application, certificate, and bond fall together. Until the state changed

its position, the bond was good, and the certificate was good as to the surety. Thus this sale of liquor in question was protected and caused no breach of the surety's obligation."

Another case on the question of misrepresentation is that of Lyman *v.* Kane and the United States Guarantee Company.[1] This action was of essentially the same nature as the one just referred to, and was brought by the excise commissioner upon a bond given for Kane, by the United States Guarantee Company, to recover the penalty of this bond. The complaint in the action alleged false statements in Kane's application for a liquor certificate. The court, in its opinion, spoke as follows:

"The claim is that the sureties are liable because the traffic was illegal, and a violation of the provision of the Liquor Tax law. The traffic was under a certificate in form authorizing it. The application was in form such as to authorize and require the treasurer to issue the certificate. Still the certificate was void, because in fact the traffic was illegal under the law, the application was false as to the facts, and the certificate afforded no protection to the traffic in view of such facts.

"That the traffic was in fact illegal and a violation of the provisions of the law, cannot be doubted. Under these circumstances, no certificate could be legally issued. . . .

"The only question is whether the sureties were liable on the bond for such illegal traffic. The condition of the bond was, 'if the said liquor tax certificate applied for is given unto the said principal, and the said principal will not, while the business for which such certificate is given shall be carried on, . . . violate any of the provisions of the liquor tax law, . . . then the obligation,' etc., shall be void.

"The claim made is that the tax certificate to be given to the principal, as a condition of making the sureties liable, must be a valid certificate, legally issued and given to the principal.

"We think this is clearly correct. The bond is to protect the state with reference to the conduct of the business by the principal, under a certificate legally issued to him. It is not intended to protect the state against the fraud of the principal in securing a certificate which is void, and in effect no certificate at all."

[1] 57 N. Y. App. Div. 549.

It has been stated, though only by way of dictum, that material misstatements on the part of the "risk" contained in an application for a liquor tax certificate create no liability on the part of a "surety company" which issues a bond given for the purpose of securing such certificate.[1]

It goes without saying that in order to establish the validity of a defence based upon misrepresentations of the insured, the insurer must show that the insured had knowledge of the fraudulent misrepresentations.[2]

§ 275. **Discharge of Liability by Concealment.** — While owing to the non-fiduciary character of statutory bonds there is little scope for the application of the doctrine of concealment as it exists in fidelity insurance, it still remains true that cases might arise wherein a proper application of the doctrine might be made even to statutory undertakings.

§ 276. **Discharge of Liability by Breach of Warranty.** — The subject-matter of breach of warranty has very little practical application to the ordinary class of statutory bonds. This for the reason that the granting of such bonds is not ordinarily preceded by the making of these written representations on the part of the insured, which might be made the basis of warranty.[3]

§ 277. **Discharge of Liability by Breach of Conditions.** — One of the implied conditions of appeal and bonds of like nature thereto is that no agreements shall be entered into between the "risk" (therein named as principal) and the insured, subsequent to the execution thereof, that shall work any material change in the situation of the parties as it

[1] Lyman *v.* Mead, *et al.*, 56 App. Div. 582; 67 N. Y. Sup. 254; see generally, Lyman *v.* Oussani, *et al.*, 33 N. Y. Misc. 409; Lyman *v.* Brucker, *et al.*, 26 N. Y. Misc. 594; Lyman *v.* Kurtz, 166 N. Y. 274; Lyman *v.* Schermerhorn, 167 N. Y. 113; Lyman *v.* B. G. H. Co., 33 N. Y. App. Div. 130; Lyman *v.* Kane, 57 N. Y. App. Div. 549; 67 N. Y. Sup. 1065.

[2] See Wilkinson *v.* U. S. Fid. & Guar. Co., 119 Wis. 226; 96 N. W. 560; Cullinan *v.* O'Connor, *et al.*, 91 N. Y. Sup. 628; 100 App. Div. 142.

[3] See Cullinan *v.* F. & C. Co., 41 N. Y. Misc. 119; 83 N. Y. Sup. 969; Lyman *v.* Schermerhorn, 167 N. Y. 113; 60 N. E. 324; Lyman *v.* Kane, 57 N. Y. App. Div. 549; 61 N. Y. Sup. 1065.

existed at the time such bond was given. In a New York case [1] it was claimed that an order made in an action subsequent to the granting of an appeal bond by the American Surety Company — the same having been made without the consent of the surety company — effected such a change in the status of the parties to the appeal as to relieve it from liability. The court overruled this claim, holding that the order complained of was expressly made without prejudice to the appeal, which it was in no wise to impair, and that it did not work any such change in the situation of the parties as to relieve the "surety company" from liability on the appeal bond. In construing an excise bond, it was said that in the event of the violation of the liquor tax law by the holder of a liquor tax certificate who had given the bond required by law, an action may be maintained against the "surety company" — which has executed the statutory bond required — to recover the penalty thereof, before any criminal proceedings have been instituted against the "risk" named in such bond. This, too, even where the law did not specify, at the time the breach of the conditions of the bond took place, as to who might bring action thereon for the enforcement of the bond; nevertheless, an action may be brought thereon by the state commissioner of excise, under authority conferred by the legislature passed subsequent to the breach of the conditions of the bond. This for the reason that such amendment in no way impaired the obligation of the bond, or changed the right of the parties, but related only to the form and mode of procedure. A general principle was enunciated in this case to the effect that where a bond is given in pursuance of a statute, the provisions of the statute are in effect part of the bond and of the contract of the "risk" and the insurer therein named.[2] Again, in Lyman *v.* Shenandoah Social Club, *et al.*,[3] it was held that the liability of a "surety company" upon

[1] Markoe *v.* Am. Sur. Co., 25 N. Y. Misc. 127; 44 App. Div. 285; 167 N. Y. 602; see also Walker *v.* Archer, *et al.*, 87 N. W. 754.

[2] Lyman *v.* Rochester Tit. & Sur. Co., *et al.*, 37 N. Y. App. Div. 234.

[3] 39 N. Y. App. Div. 459.

an excise bond is not limited to the civil or criminal penalties described in the statute requiring the giving of such a bond as a condition precedent to the right to sell liquors. It was held upon proof that the premises where the liquor was sold were disorderly, and that it was sold thereon at times forbidden by law, that for any violation of the conditions of the bond the surety company issuing the same becomes obligated to pay damages in the penal sum mentioned in the bond, independently of the fact that a judgment for a like amount may have been obtained against the "risk" named in such bond, in an action against him for the civil penalties.[1]

One of the implied conditions of every statutory bond is that the insured must have what is known as an insurable interest in the policy issued in its behalf. An interesting question in this connection was raised in the case of American Surety Company *v.* Campbell and Zell Company.[2] In this case a bond discharging a judgment had been executed by a surety company in behalf of a receiver of a corporation. The insured under this attachment bond was one H., receiver of the Campbell and Zell Company, a corporation. The bond recited that the penalty thereof was to be paid to said H., his successors or assigns. The court held that the conditions of the bond were such as to authorize suit to be brought on the bond directly in the name of the Campbell and Zell Company after the termination of the receivership. In determining this question the court spoke as follows:

"As a general rule an action on an attachment bond, as well as upon other bonds under seal, must be in the name of the obligee, when the name is clearly defined, and is without addition or descriptive enlargement; but who the real obligee is, is often a matter of construction. In this case, it is true, the condition in the bond is to pay the plaintiff in the action, and the principal question here relates to the inquiry as to whom the plaintiff and real obligee is. This inquiry must be solved, as observed by the learned judge in the Circuit Court, upon a consideration and construction of the whole contract, having

[1] See also Lyman *v.* Gramercy Club, *et al.*, 39 N. Y. App. Div. 661.
[2] 138 Fed. 531.

regard, of course, to the character of the proceeding on which the bond relates, as the condition in the bond expressly refers to the writ of the plaintiff in the action in which the bond was given, and because the description of the obligee embraces something more than the individual name of Homer. The name of Charles C. Homer was only part of the description of the obligee. In every substantial sense the real obligee was the Campbell and Zell Co. Homer, as receiver, was simply an official and the instrument of the law, and as such represented the corporate interest, and in such representative capacity brought an action for the benefit of the company to establish its rights and to recover upon a debt due it as the disclosed beneficiary. The bond was not to Homer individually, but Homer as receiver, not in so many words, but to 'Charles C. Homer, of the State of Maryland, Receiver of the Campbell and Zell Company, a corporation originally under the laws of the State of Maryland, in the full and just sum of five thousand dollars, to be paid to said Charles C. Homer, his successors and assigns.'

"His capacity was fully disclosed. The receiver sued not for himself but officially and as an instrument of the law for the corporation, which was temporarily incapacitated from suing; and when the incapacity was removed by the termination of the receivership control over the action, the disclosed beneficiary became his successor and fully succeeded to all rights in respect to the action and the bond dissolving the attachment, which the receiver, an instrument of the law, had created in its behalf. The writ and the bond itself set out to the surety company full information in respect to the character of the claim and as to the real plaintiff and obligee in interest. The parties contracted with reference to a receivership situation, which was liable to be terminated at any moment, the beneficiary thereupon succeeding to all right to carry forward pending legal proceedings for the collection of its just claims. It should be assumed upon construction that the parties understood all this, as they undoubtedly did. It is a miscarriage of justice, if a bond discharging an attachment in a suit by a receiver in behalf of a disclosed beneficiary interest, which is set out in a description of the party plaintiff, and as a part of the description of the party obligee in the bond as well, is not enforceable by the beneficiary, and an asset is lost because the receivership control over the action terminates before the action instituted in behalf of the beneficiary is brought to a conclusion. We need not, however, consider whether, under construction of the whole contract, the interest of Campbell and Zell is so substantial and so apparent,

and the corporate name so substantial a part of the description of the obligee, as to entitle the corporation to sue in its own name upon the bond as the expressed obligee.

"This case may be rested upon the position that the bond expressly runs to Homer in his official and representative capacity, and expressly to his successors as well. This results because the bond itself contemplates succession. As has already been said, the action in question was by a receiver who fully disclosed his official capacity and described by name the beneficiary plaintiff. The action was to recover upon an indebtedness to the disclosed, but temporarily incapacitated, company. This bond was filed in the ordinary course of judicial procedure, discharged a valid attachment and was subject to the ordinary course of judicial procedure, including the amendment striking out the representative capacity of Homer, and leaving the action to be prosecuted by Campbell and Zell, the disclosed party in interest, the real plaintiff and beneficiary.

"Without regard to the real plaintiff or the receiver, the defendant exercised its arbitrary right under the statute to discharge its property by filing a bond of attachment. It would be a harsh rule that would make the real plaintiff lose its claim or right of action against the sureties because the bond was given to its receiver who, as an officer of the law, was safeguarding its interest, and the interests of its creditors, and because the receiver was superseded by the real plaintiff who, by the amendment, had succeeded to its original right, before the judgment was recovered which the bond was intended to secure. By operation of law, the moment the receivership control over the action terminated, upon motion of the receiver, the corporation, under the terms of the bond, succeeded to all the rights created by the receiver in its behalf during the time in which it was incapacitated from bringing the suit."[1]

[1] See generally on the subject of discharge of liability by breach of conditions, the following cases: Cullinan *v.* Kuch, 177 N. Y. 303; 15 Bedell 345; Cullinan *v.* Parker, 80 N. Y. Sup. 187; 39 Misc. 446; Cassidy *v.* McFadden & Saline Co., Ind. Terr. ; 104 S. W. 829; Doon *v.* Am. Sur. Co., 97 N. Y. Sup. 270; 110 App. Div. 215; Cullinan *v.* F. & C. Co., 83 N. Y. Sup. 969; 41 Misc. 119; Crane *v.* Buckley, 27 Sup. Ct. 56; 203 U. S. 44; Nat. Sur. Co. *v.* Walker, 127 Ia. 518; 101 N. W. 780; U. S. Fid. & Guar. Co. *v.* Boyd, 29 Ky. L. Rep. 598; 94 S. W. 35; Gregory *v.* U. S. Fid. & Guar. Co., 91 N. Y. Sup. 595; 45 Misc. 112; Muskogee Land Co. *v.* Blackborn, Okla. ; 95 Pac. 252; Jackson *v.* Law. Sur. Co., 88 N. Y. Sup. 576; Cullinan *v.* Burkhard, 86 N. Y. Sup. 1003.

An insurer has the right to require a strict compliance with the terms of a statutory bond furnished by it. Any alteration of the contract by the "risk" without the consent of the surety is fatal to its validity as against the insurer. This is true, although the insurer sustains no injury by the change and even if the change be for his benefit.[1]

§ 278. **Notice and Proof of Loss.** — As a general rule notice of loss to the insurer is required in order to enable the insured to enforce the former's liability under a statutory bond, unless such notice is made necessary by express statutory provision, or by the insertion of a condition to that effect in the bond. As a general rule, ordinarily proof of loss is the introduction into evidence of some judgment or decree of court, the rendition of which is made a condition of the creation of liability of the insurer to the insured under the bond. Ordinarily such judgment and decree are conclusive upon the insurer.[2]

Sometimes, however, such judgments and decrees are only *prima facie* binding on the insurer. In such cases the latter can relieve itself from the effect of the recovery of a judgment in favor of the insured against the "risk" by showing that the amount recovered was in excess of the amount which the plaintiff under the judgment or decree was really entitled to recover, or that he was not entitled to recover at all.[3]

[1] Bauschard Co. *v.* F. & C. Co. of N. Y., 21 Pa. Sup. Ct. 370.

[2] See generally on this subject the following cases: Tyng *v.* Am. Sur. Co., 74 N. Y. Sup. 502; Fid. & Dep. Co. *v.* Kepley, 66 Kan. 343; 71 Pac. 818; Selby, *et al.* *v.* City of New Orleans, 119 La. 900; 44 Sou. 722; Culver *v.* Fid. & Dep. Co., 149 Mich. 630; 113 N. W. 9; Drought *v.* Page, Ga. ; 59 S. E. 728; Ciniotte Unhairing Co., *et al.* *v.* Fur Refining Co., *et al.*, 158 Fed. 171; Fromme *v.* U. S. Sur. & Guar. Co., 78 N. Y. Sup. 895; 39 Misc. 105; Em. St. etc. Co. *v.* Hanley, 136 Fed. 99; Dunne *v.* Nat. Sur. Co., 80 N. Y. Sup. 744; 80 App. Div. 605.

[3] Griffin *v.* State to the Use of, etc., 104 Md. 71; Atl. ; see also Price, *et al.* *v.* Wakeham, Tex. ; 107 S. W. 133; Fid. & Dep. Co. of Md. *v.* Sturtevant Co. 86 Miss. 509; 38 Sou. 783; MacDonald *v.* City Tr. Safe Dep. & Sur. Co., 80 N. Y. Sup. 405; 39 Misc. 552; Cit. Tr. & Sur. Co. *v.* Goodchild, 195 Pa. 80; 45 Atl. 662;

§ 279. **Discharge of Liability by Settlement of Loss.** — The measure of the sureties' liability is fixed by the terms of the instrument they sign, and such undertaking cannot be enlarged or varied by judicial construction. The bond will be construed as the words are ordinarily understood. The liability of the "surety companies" on either a bond for costs on appeal, or on a supersedeas bond or on an indemnity appeal bond is contingent, and anything legally satisfying the judgment appealed from or removing the liability of the principal will discharge the surety.[1] On reversal of such a judgment the "surety company" is ordinarily discharged. In general, the liability of a surety on all classes of statutory bonds is that of his principal. The extent of the recovery on supersedeas bonds is generally the amount of the judgment covered by the bond, with interest and costs in both upper and lower courts, unless the bond otherwise provides. On cost bonds upon appeal, the extent of the "surety companies'" liability usually embraces statutory costs on the appeal and disbursements, as specified in the statute governing the subject.[2] In Epstein *v.* United States Fidelity and Guaranty Company,[3] where the assignee of a claim for damages by one whose property had been attached brought an act to recover damages therefor after the attachment had been vacated, and subsequent to the bringing of such action the order vacating the attachment was vacated, — which last order was by a subsequent order likewise vacated, — it was

Friefield, *et al.* *v.* Sire, 89 N. Y. Sup. 260; 96 App. Div. 296; Baer *v.* Fid. Co. of Md., 130 Fed. 94; Fowler, *et al.* *v.* State to Use of Gray, 99 Md. 594; 58 Atl. 444. See also as to proof of loss under liquor and distiller's bonds the following cases: U. S. *v.* Nat. Sur. Co., 157 Fed. 174; Cullinan *v.* Federal Union Sur. Co., 100 N. Y. Sup. 515; 51 Misc. 643; Clement *v.* Federal Sur. Co., 106 N. Y. Sup. 1061; City Tr. Safe Dep. & Sur. Co. *v.* Am. Brewing Co., 182 N. Y. 285; 74 N. E. 948; Freeman *v.* U. S., 157 Fed. 195; Bingham Co. *v.* Fid. & Dep. Co., 13 Ida. 34; 88 Pac. 829.

[1] See Vent *v.* Duluth Tr. Co., 80 N. W. 640.

[2] See Kleiner *v.* Fid. & Dep. Co., 33 N. Y. Misc. Rep. 188.

[3] 61 N. Y. App. Div. 527; 29 N. Y. Misc. 295.

held that an action on the attachment bond was not prematurely brought.[1]

In an action by the assignee in insolvency on a replevin bond against the assignees for property sold to insolvent by plaintiffs in the replevin suit, it was said that the note given by insolvent for the goods replevied cannot be pleaded as a set-off.[2] An action on a bond given in the course of litigation cannot in general be maintained until the determination of the litigation in which it is issued.[3] In an action upon an excise bond given for a liquor dealer by a "surety company" to a county treasurer, the right of the state commissioner of excise to maintain an action upon such a bond, either for the recovery of the entire penalty for any breach of any condition of the bond, or for the amount of any penalty or penalties incurred or imposed for a violation of the law, was sustained. In that case it was said that "in a case between the government and the private surety, in which the purpose of the bond is to secure the observance of the law in pursuance of which the bond is given, and punishment or satisfaction for its non-observance, the penalty named in the bond is the measure of the damages for its breach, unless the statute under which the bond is given or the bond itself, as read in the light of the statute, indicates a less or different measure. In such cases in which the statute fixes the measure of the damages, the courts cannot relieve against it unless authorized by statute to do so. The limits of the forfeiture of appeal in criminal cases may be cited as one instance of the power to afford relief. There may be other instances, but few, and the exceptions seem to prove the rule. Where the breach of the condition is an offence against public law or policy, pecuniary damages which have followed are usually a minor incident. The affront is to the state and its sovereign will; but some sort of satisfaction should be exacted, and

[1] See generally Fid. & Dep. Co. v. Singer, 50 Atl. 518.

[2] Fid. & Dep. Co. v. Haines, *et al.*, 78 Md. 454; 28 Atl. Rep. 393.

[3] Boughton v. Omaha Loan & Tr. Co., 73 Mo. App. 597.

when the statute has fixed its measure in money, the courts must award it. That the excise commissioner might have sued upon the bond as collateral security for the single offence need not be questioned; the question is, Does the statute give him the right to recover the entire penalty because of the single offence?

"The action is not to recover any fine imposed upon conviction or penalty previously recovered in a civil action, and the bond is not limited to its collateral quality in either respect. It seems to be the intent of the section, as amended in 1897, to give to the bond a broader scope; namely, to subject the offender to the larger penalty in case the state commissioner of excise, the special administrator of the law, should think fit to bring the action for that purpose. It is common knowledge that the temptation to violate this and previous excise laws has developed a fertility and variety of abuses, evasions and violations that, in default of rigorous treatment, weaken the efficiency of the law, both as a revenue measure and as a regulator of the liquor traffic. Recourse to the penalty named in the bond, instead of the fine or penalty named in any section of the act for a specific violation, was no doubt thought to be necessary in order to secure observance of the provisions of the act. If the surety thereby suffers and the offender sometimes escapes, the public may benefit by inducing the surety to become more watchful of the character of the vendor for whose fidelity he engages, and thus violations will be lessened by making it more difficult for lawless men to obtain their bonds, and when they obtain them, to make them more circumspect in regard to the obligations they have assumed. Such, we think, is one of the purposes of the section providing for his bond, and the recovery is within its letter and spirit. It would be unjust under these circumstances to permit them to repudiate their obligation." [1]

In Epstein *v.* United States Fidelity and Guaranty Company [2] it was held that where assignees of an undertaking issued by a "surety company" to their assignors, to procure an attachment which was subsequently vacated, bring an action against such "surety company" for the purpose of

[1] Lyman *v.* Perlmutter, 166 N. Y. 410; 60 N. E. 21.
[2] 29 N. Y. Misc. 295.

recovering damages sustained by the attachment, the reinstatement of the attachment and the subsequent vacation of the order reinstating it, by orders made pending the action, have no effect upon the right of the assignees to sue and recover on the " surety company's " undertaking.

It was further held that a demand is unnecessary as a condition precedent to the maintenance of an action against the " surety company," as its obligation is absolute. The bringing of the action itself was held to constitute such a demand.

In Sooysmith and Company *v.* American Surety Company [1] the bond sued on was worded so as to provide " that a surety company, issuing an undertaking to discharge an attachment should, on demand, pay to the plaintiff the amount of any judgment that might be recovered in the action against the defendant, not exceeding the sum of $5000, with interest." It was held, first, that the interest, under a proper construction of the undertaking, ran from the date of the recovery of the judgment in the action, and not from the date of such undertaking; and, secondly, that under such an instrument the right of action thereon accrued only upon demand. The sum specified therein, it was said, becomes due upon the recovery of the judgment in the main action, and upon demand becomes payable with interest from that date.

Where the " surety company " issues an undertaking for the purpose of admitting a judgment debtor to the jail liberties, it is liable thereon to the insured for the total amount of the debt for which said judgment debtor was committed, even though the latter be solvent. Where the " risk " subsequently escapes from such liberties, the voluntary return of such judgment debtor to the jail liberties does not relieve the "surety company" from liability on its undertaking, especially where it appears that the action was commenced upon such an undertaking by the service of a summons upon the judgment debtor when he was actually outside of the jail liberties.[2]

[1] 28 N. Y. App. Div. 346.

[2] Flynn *v.* U. S. Sur. & Guar. Co., 61 App. Div. 170; see in this connection, Mayne *v.* Fid. & Dep. Co., 8 Penn. Dist. Ct. 711.

Attachment being a statutory remedy, the measure of damages reasonable for breach of an attachment bond is one generally governed by the law of the state as expressed in its constitution and statutes and as declared by its highest court. In the case of attachment bonds reasonable attorney's fees in procuring a dissolution of an attachment and aside from those incurred in the main case are recoverable as an element of damage in an action thereon.[1]

It should be borne in mind that a statutory bond does not, unless made so by express terms, measure all the liability of the "risk" therein named to the insured. Neither can the insurer under all circumstances be made to respond to the insured for every liability incurred by such "risk."[2] With respect to proof of loss under statutory bonds, it may be said that judgments obtained by the insured against the "risk" are usually conclusive against the insurer, in the absence of fraud or collusion between the insured and the "risk," where the cause of action is the same. This is undoubtedly true in those cases where the insurer is "vouched in" by the "risk" as soon as suit is brought against the latter by the insured, and the insurer refuses to defend on the ground of alleged non-liability.[3]

[1] Bucki & Son Lumber Co. *v.* Fid. & Dep. Co., 109 Fed. 393.

[2] People *ex rel.* Hill *v.* United Sur. Co., 120 N. Y. App. Div. 655; 105 N. Y. Sup. 72; Lyman *v.* Shenandoah Social Club, 39 N. Y. App. Div. 459; Lyman *v.* R. T. Ins. Co., 37 N. Y. App. Div. 234. See generally on attachment bonds: Epstein *v.* U. S. Fid. & Guar. Co., 61 N. Y. Sup. 527; Tyng *v.* Am. Sur. Co., 48 App. Div. N. Y. 240; Anderson, *et al.* *v.* Fid. & Dep. Co., 100 Ga. 739; 28 S. E. 463; Morgan, *et al.* *v.* Fid. & Dep. Co., 101 Ga. 389; 28 S. E. 857; Eldridge *v.* Fid. & Dep. Co., Tex. App. ; 63 S. W. 955; Schwartz *v.* Fid. & Dep. Co., 105 La. 161; 24 Sou. Rep. 479; Bacon *v.* Am. Sur. Co., 53 N. Y. App. Div. 150; Kleiner *v.* Fid. & Dep. Co., 33 N. Y. Misc. Rep. 188; see also McCormick *v.* Nat. Sur. Co., 66 Pac. 741; Sheldon *v.* Fid. Tr. & Guar. Co., 71 N. Y. Sup. 65; 72 N. Y. Sup. 1128; St. P. Tit. & Tr. Co. *v.* Sabin, *et al.*, 112 Wis. 105; 87 N. W. 1109; Fid. & Dep. Co. *v.* Singer, 50 Atl. 518; on removal bonds, Hollister *v.* U. S. Fid. & Guar. Co., 84 Minn. 251; 87 N. W. 776.

[3] B. Roth Tool Co. *v.* New Amsterdam Cas. Co., 161 Fed. 709. In connection with the subject-matter of statutory insurance bonds see the following cases:

on admiralty bonds, see The Bencliff, 158 Fed. 377; official bonds, Scot *v.* Commonwealth for Use of etc., 29 Ky. L. Rep. 571; U. S. Fid. & Guar. Co. *v.* Milestead, Ky., 109 S. W. 875; jail liberties, McLean *v.* Fid. & Dep. Co., 107 N. Y. Sup. 907; injunction, White Pine Lumber Co. *v.* Ætna Indemn. Co., 42 Wash. 569; 85 Pac. 52; U. S. Fid. & Guar. Co. *v.* Jones, Ky. ; 111 S. W. 298; Fid. & Dep. Co. *v.* Tinsley, 30 Ky. L. Rep. 1095; Nat. Soc. of U. S. Daughters of 1812 *v.* Am. Sur. Co. of N. Y., 107 N. Y. Sup. 820; replevin, Freeman *v.* U. S. Fid. & Guar. Co., 87 N. Y. Sup. 493; 43 Misc. 364; supersedeas bond, U. S. Fid. & Guar. Co. *v.* Boyd, 29 Ky. L. Rep. 398; 94 S. W. 35; appeal, Tyng *v.* Am. Sur. Co., 174 N. Y. 166; 66 N. E. 668; Baer *v.* Fid. & Dep. Co., 130 Fed. 974; Doon *v.* Am. Sur. Co., 97 N. Y. Sup. 270; 110 App. 215; forthcoming bond, Fid. & Dep. Co. *v.* B. F. Sturtevant Co., 86 Miss. 509; 38 Sou. 783; bankruptcy, Nixon, *et al.* *v.* Fid. & Dep. Co., 150 Fed. 574; attachment, Am. Sur. Co. *v.* Campbell & Zell Co., 138 Fed. 531; probate, Williams *v.* Fid. & Dep. Co., Col. ; 93 Pac. 1119; Held *v.* Burke, *et al.*, 83 App. Div. 509; 82 N. Y. Sup. 426; sheriff's bond, Sloan *v.* Nat. Sur. Co., 97 N. Y. Sup. 561; 111 App. Div. 94; State *ex rel.* Kennan *v.* Fid. & Dep. Co., 94 Mo. App. 184; 67 S. W. 958; liquor, Cullinan *v.* Furthmann, *et al.*, 75 N. Y. Sup. 90; 70 App. Div. 10; People *ex rel.* Hill, *et al.* *v.* Union Sur. Co., 105 N. Y. Sup. 72; 120 App. Div. 655; Cullinan *v.* Bowker, *et al.*, 82 N. Y. Sup. 707; 40 Misc. 439; distiller's, U. S. *v.* Nat. Sur. Co., 157 Fed. 174; Nat. Sur. Co. *v.* Button, Ind. ; 83 N. E. 644.

PART VI

CHAPTER XXII

THE RIGHTS OF SUBROGATION, CONTRIBUTION AND EXONERATION IN THE LAW OF GUARANTY INSURANCE

§ 280. **The General Doctrine of Subrogation in Guaranty Insurance.** — In no branch of insurance law does the principle of subrogation play such an important part as in that of guaranty insurance. The existence of such a right in favor of the insurer, as an incident to the existence of the relationship of insurer to insured, in a sense characterizes the contract of guaranty insurance in its relation to other branches of insurance law. There is no subsidiary branch of guaranty insurance in which the right of subrogation may not be said to exist. This statement applies to the fullest extent to the subject-matter of fidelity, commercial and judicial insurances.

Generally speaking the right of subrogation does not arise primarily from any terms of the policy of guaranty insurance. While it frequently happens that provision is made for it in the policy, yet the right exists irrespective thereof. Guaranty insurance being a contract of indemnity pure and simple, it naturally follows that after the insured has been fully indemnified by the insurer, all opportunity for further indemnification should be taken away from him. This is done by the adoption of the "doctrine of subrogation" into insurance law. The reason for such adoption is the one just given above rather than, as has been frequently supposed, the striking analogy existing between the contract of guaranty insurance and that of private suretyship.

It has been well said that subrogation is not a doctrine

applied to insurance law on the ground that underwriters are sureties. They have rights which are somewhat similar to the rights of sureties, but that, again, is in order to prevent the assured from recovering more than a full indemnity.[1]

As a matter of fact all the benefits of subrogation, and even more, may be obtained by the insurer after payment of a loss under a policy of guaranty insurance, through the enforcement of the "risk's" express or implied agreement to indemnify the insurer against any loss that may come to it through the issuance of the policy in question.

The difference in legal effect that exists between that right of subrogation which is extended to the insurer under the principles of insurance law, and that concurrent right just referred to as arising out of the "risk's" express or implied agreement to indemnify, may be here referred to. Just wherein the difference lies may be explained as follows: As an insurer the "surety company's" right of subrogation does not rest upon any relation of contract or of privity between such insurer and the "risk." Therefore a request from the "risk" to the insurer to issue such a policy is not necessary to the existence of the right.[2] It arises out of the nature of the contract of insurance as one of indemnity and is derived from the insured alone and can be enforced in his right only. In any event the insurer can take nothing by such subrogation but the right of the insured, and if the latter has no right of action against the "risk," none passes to the insured.[3]

From what has been said it is clear that where the right of subrogation is claimed by the "surety company" in the capacity of an insurer and not as a surety or guarantor for the "risk," it may be subject in its operation to substantial equities existing in favor of the "risk" as against the insured.[4]

[1] Castallain *v.* Preston, L. R. 11 Q. B. D. 380.

[2] See Herpolsheiner *v.* Hansell-Elcock Co., 141 Mich. 367.

[3] St. L. I. M. & S. R. Co. *v.* Com. Union Ins. Co., 139 U. S. 223; 35 L. E. 157; Henningsen *v.* U. S. Fid. & Guar. Co., 208 U. S. 404.

[4] See Merc. Mut. Ins. Co. *v.* Calebs, *et al.*, 20 N. Y. 175.

On the other hand, the right of exoneration which belongs to the insurer by reason of having furnished the policy at the request of the "risk," is in reality a right based on an implied agreement on the part of the "risk" to indemnify the insurer against any loss incurred by reason of the issuance of such policy. It arises in such a case, not out of the contract of insurance, but out of the implied contract of indemnity existing between the "risk" and the insurer. This right can be enforced without being in any manner limited or controlled by agreements entered into by the insured with the "risk" or by equities subsisting between them.[1]

Reserving for subsequent sections of this work a consideration of the rights of the insurer under the "risk's" express or implied contract of indemnity, our attention will be directed solely in this immediate connection to the insurer's right of subrogation growing out of the contract of insurance entered into between it and the insured.

Speaking in general terms, upon payment of a loss under the policy to the insured, the insurer thereupon becomes subrogated to the rights of the insured as against the "risk," and can in its own name or in the name of the insured or in their joint names maintain an action against the "risk" for indemnity, provided the latter is legally responsible to the insured for the loss paid by the insurer under the policy. The right of subrogation is not open to a stranger to the contract of guaranty insurance or to one who volunteers to pay a debt for which the "risk" is not legally liable to the insured.[2] Under such circumstances the acceptance of a given amount from the insurer by the insured, in full discharge of the former's liability to the latter under the policy, does not in any manner affect the right of the insured to recover from the "risk" the whole amount of the loss for which the latter was responsible under his contract with the insured. The

[1] See Ch. St. L. & N. O. Ry. Co. *v.* Pull. Sou. Car Co., 139 U. S. 79; Fid. & Dep. Co. *v.* Haines & Stokes, 78 Md. 454; 28 Atl. 393.

[2] Herpolsheiner *v.* Hansell-Elcock Co., 141 Mich. 367; 104 N. W. 671; Henningsen *v.* U. S. Fid. & Guar. Co., 208 U. S. 404.

insured under such circumstances can recover only one satisfaction for the loss, and if the amount recovered from the "risk," increased by the sum paid by the insurer to the insured, be more than sufficient for the latter's just indemnity, the excess must be held by it in trust for the former. The inquiry in all such cases, undertaken for the benefit of the insurer, is as to the amount for which the "risk" is bound under its contract with the insured, and the latter's recovery thereon is not affected or limited by the amount it has been able to collect from the insurer under the policy of insurance. In all cases where the insurer seeks to enforce the right of subrogation as against the "risk," although it be the sole party beneficially interested, yet its rights are to be worked out through the cause of action which the insured has against the "risk." In such an action the "risk" is bound to respond for all damages sustained through the identical breach of his contract with the insured, which was itself made the basis of the insured's claim under the policy against the insurer. If only part of the loss has been paid by the insurer, the insured is entitled to the residue. This last for the reason that the liability of the "risk" is in legal effect first and principal and that of the insurer secondary, not in order of time but in order of ultimate recovery. The insurance is to be treated for what it is in law, a mere indemnity, and the insured and the insurer are to be regarded for the purpose of enforcing the former's rights against the "risk" for the benefit of the latter as one person. Therefore payment by the insurer before such suit is brought cannot affect the right of action possessed by the insured as against the "risk."

The general rule of law is that where there is a contract of guaranty insurance, and a loss happens, anything which reduces or diminishes that loss reduces or diminishes the amount which the insurer is bound to pay; and if the insurer has already paid it, then if anything which diminishes the loss comes into the hands of the person who has already been paid

the full indemnity, it then becomes the property of the party who had furnished such indemnity.[1]

It is now well settled that the acceptance of payment of loss by the insured from the insurer subrogates the latter to all the rights of the insured against third parties instrumental in causing the loss so paid. The payment of such loss puts the insurer in all respects into the place which the insured occupied in relation to the latter's claim against such third parties. The acceptance of payment from the insured under such circumstances operates as a virtual assignment of the cause of action to the insurer, and any part payment operates as an assignment *pro tanto*. The consent of the "risk," either to the issuance of the policy or the payment of loss thereunder, is not necessary in order to entitle the insurer to exercise the right of subrogation. In all cases the insurer must actually settle an existing liability under the policy in order to entitle it to the right of subrogation.[2]

§ 281. **The Right of Subrogation in Fidelity Insurance.** — The nature of the insurer's right of subrogation in fidelity insurance is clearly pointed out by the court in London Guaranty and Accident Company *v.* Geddes.[3] It was there observed that there would in any event be no liability on the part of the insurer to the insured under a fidelity insurance policy but for the embezzlement of the "risk." "If," said the court, "the 'risk' had faithfully and honestly performed his duties to the insured, the latter would have no cause of action against him. For this reason there could be no legal difference in the relation which the insurer sustains to the 'risk,'

[1] Ch. St. L. & N. O. Ry. Co. *v.* Pull. Sou. Car Co., 139 U. S. 79; 35 L. E. p. 97; Ins. Co. of N. A. *v.* Fid. etc. Co., 123 Pa. St. 223; 16 Atl. Rep. 791; Fid. & Tr. Co. *v.* People's Nat. Gas Co., 150 Pa. St. 8; 24 Atl. Rep. 339.

[2] See Ins. Co. of N. A. *v.* Fid. etc. Co., 123 Pa. St. 223; 16 Atl. Rep. 791; Fid. Tit. & Tr. Co. *v.* People's Nat. Gas Co., 150 Pa. St. 8; 24 Atl. Rep. 339; Am. Bond. & Tr. Co. *v.* L. & W. Va. Guar. Co., 95 Fed. 49; Central Tr. Co. *v.* Louisville Tr. Co., 100 Fed. 545; 40 C. C. A. 530.

[3] 22 Fed. 639.

and the relation which a private person signing as surety on his bond would have sustained to him.

"In such a case the insurer would have the same remedy that the insured would have after the payment to it of the loss by the former. The insurer, under the circumstances, stands in the shoes of the insured, and has a right to be subrogated to all the rights of such insured in the prosecution of the 'risk.'" Continuing, the court observed, "that there was a principle of public interest involved in this question that should entitle the insurer to all the remedies that the insured would have. We all know," observed the court, "that in the case of large corporations whose sole business it is to make, handle and disburse money for the benefit of stockholders or parties interested in their earnings, if they get their money from the sureties of their dishonest employees, they will not prosecute the employee, either civilly or criminally. They will simply stand on the bond, and if they get their money from the surety, they leave the punishment of the dishonest servant to the man who has suffered rather than spend their money in prosecution which either directly or indirectly may punish the wrongdoer. It seems to me that the common dictates of public policy should give to the surety of such employer the same remedy that the defrauded employer should have."

As soon as the insurer pays the debt of the "risk" there arises in his favor an equity to have the securities held by the insured for his debt turned over to him and to avail himself as fully of them as the insured might have done. For the purpose of indemnity, the insurer is entitled to be subrogated to all rights, remedies and securities of the insured arising out of the claim that is made the basis of the insurer's liability under the policy, and entitled to enforce his liens, priorities and means of payment as against the "risk." As a general rule to give effect to the manifest intention of parties to extend to the insurer the right of subrogation, it must be held to be coextensive with the right of the insured to proceed against the "risk" for the purpose of enforcing the

identical claim which it has sought to enforce against the insurer under the policy. On account of the necessity of an insurable interest in the insured and by reason of the fact that insurance is a contract of indemnity, the insurance agreement itself is treated as accessory to the original contract of employment entered into between the insured and the "risk" and adheres to it, and the power to enforce the right of subrogation on the part of the insurer against the "risk" must be determined by the correlative right of the insured to demand enforcement of the corresponding obligation of the "risk" under the contract of employment existing between such "risk" and the insured.

Where only partial settlement is made by the insurer with the insured of a claim under the policy, it would seem that the right of subrogation can nevertheless be enforced for the full amount in favor of the insured against the "risk," subject, however, to the obligation on the part of the former to account for any excess to the insured.[1]

The existence of the insurer's right of subrogation in the case of private fidelity bonds is fully recognized in all jurisdictions.[2]

There seems also to be no doubt but what the right of subrogation exists to the same extent in favor of surety companies executing official bonds as has been seen to exist in the case of private fidelity bonds.[3]

[1] Ch. St. L. & N. O. Ry. Co. *v.* Pull. Sou. Car Co., 139 U. S. 79. See generally, as to the right of subrogation of the insurer under policies of fidelity insurance, the following cases: Guar. Co. of N. A. *v.* East Rome Town Co., 96 Ga. 511; 23 S. E. Rep. 503.

[2] Fid. & Dep. Co. *v.* Jordan, *et al.*, 134 N. C. 236; 46 S. E. 496; Am. Bond. Co. of Baltimore *v.* Nat. Mech. Bank of Baltimore, 97 Md. Ct. of App., 598; 55 Atl. 395; State *ex rel.* Moore *v.* Perkins, 114 La. 301; Am. Bond. Co. of Baltimore *v.* First Nat. Bank of Covington, 27 Ky. L. Rep. 393; Champion Ice & Cold Storage Co. *v.* Am. Bond. & Tr. Co., 25 Ky. Ct. of App. 239; 75 S. W. 197; Fid. & Dep. Co. of Md. *v.* Fid. & Tr. Co., *et al.*, 143 Fed. 152; U. S. Fid. & Guar. Co. *v.* Messick Grocery Co., N. C. ; 61 S. E. 375.

[3] See Am. Bond. Co. *v.* Nat. Mech. Bank of Baltimore, 97 Md. 598; 55 Atl. 395; Fid. & Dep. Co. *v.* Jordan, *et al.*, 134 N. C. 236; 46 S. E. 496; Nat. Sur. Co.

§ 282. **The Right of Subrogation in Commercial Insurance.** — The right of subrogation belongs to the insurer on payment by it to the insured of a loss coming within the scope of liability under a policy of commercial insurance.[1] Where an insurer assumes, in pursuance of the terms of its undertaking, the performance of the "risk's" contract, it is subrogated to the rights of the insured in such contract and becomes subject to all his liabilities.[2] This is true in all branches of commercial insurance, whether contract, credit or title insurance.[3]

The insurer issuing a contractor's bond, who assumes and completes the work after its abandonment by the risk, is subrogated, so far as is necessary to protect him from loss, to all rights which the insured might have enforced against the "risk" if it had declared the contract forfeited and completed the work itself.[4] The court in this case observed that the right of subrogation has its origin, not in the contract, but in equity, and it goes no further than the strict demands of equity and justice demand.[5]

In a late Pennsylvania case[6] it appeared that a "surety

v. State Sav. Bank, 156 Fed. 21; Baker, *et al.* *v.* Fid. & Dep. Co., 24 Ky. L. Rep. 900; 73 S. W. 1025.

[1] St. P. Tit. Ins. Co. of N. A. *v.* East Rome Town Co., 96 Ga. 511; 23 S. E. 503; Fid. Tit. & Tr. Co. *v.* People's Nat. Gas Co., 150 Pa. St. 8; 24 Atl. Rep. 339; Dane *v.* Mortgage Ins. Co., 1 Q. B. 54 (1894); Am. Sur. Co. *v.* Law. Com. Co., *et al.*, 96 Fed. 25, 30; 110 Fed. 717; Cit. Tr. & Sur. Co. *v.* Goodchild, 195 Pa. 80; 45 Atl. Rep. 662.

[2] Ausplund *v.* Ætna Indemn. Co., 47 Ore. 10; 81 Pac. 877.

[3] See Henningsen *v.* U. S. Fid. & Guar. Co., 208 U. S. 404.

[4] First Nat. Bank of Seattle *v.* City Tr. Safe Dep. & Sur. Co., *et al.*, 114 Fed. 529.

[5] See to the same effect, Town of Gastonia, *et al.* *v.* McEntee-Peterson Eng. Co., *et al.*, 131 N. C. 363; 42 S. E. 857; Ins. Co. of N. A. *v.* Fid. & Tr. Co., 123 Pa. St. 523; Am. Sur. Co. *v.* Lawrenceville Cem. Co., 110 Fed. 716; Conklin, *et al.* *v.* U. S. Ship Bldg. Co., 136 Fed. 1006; Henningsen *v.* U. S. Fid. & Guar. Co., 208 U. S. 404; 28 Sup. Ct. 389; Stehle, *et al.* *v.* Union Sur. Co., Md. ; 68 Atl. 600; Am. Sur. Co. *v.* Akron Sav. Bank Co., 6 O. Cir. Rep. 374; Muscrelli *v.* Merc. Tr. Co., Pa. ; 69 Atl. 1140; Fid. & Dep. Co. of Md. *v.* Nat. Bank of Commerce of Dallas, *et al.*, Tex. ; 106 S. W. 782.

[6] Fid. Tit. & Tr. Co. *v.* Peoples Nat. Guar. Co., 150 Pa. St. 8; 24 Atl. 339.

company" had issued a policy to a mortgagee insuring his title to the mortgaged premises and indemnifying him against loss by reason of the non-completion of certain buildings agreed to be built upon the mortgaged premises at the time the mortgage loan was made. The policy also guaranteed the mortgagee against loss by reason of claims of mechanics' liens or material men and undertook to see that the amount of the mortgage loan should go to paying laborers and material men. The "risk" made an assignment before the completion of the work, and the "surety company" at this time still had $10,000 out of the total mortgage loan of $56,000 under its control. The insured called on the insurer to complete the buildings under the contract of indemnity, and it did so, and in the course thereof expended more than $10,000. For this reason it refused possession of the premises to the assignee of the "risk" and rented them. It was held that it had no right to retain the rents to reimburse itself for its expenditures, but must seek repayment on the same basis as other creditors.

The right to enforce subrogation against the "risk" may be lost by acts of the insurer. An excellent example of such a case is to be found in American Surety Company *v.* Ballman, *et al.*[1]

Here a "surety company" issued a contractor's bond in behalf of Trumanhauser Brothers to the Burlington Elevator Company. The former at the same time gave the "surety company" an indemnifying bond signed by themselves, Ballman and Durfee. The elevator company sued the "surety company," and the latter notified the parties to the indemnifying bond to come in and defend. They did, and in the name of the "surety company" conducted a vigorous defence. A judgment was rendered against the "surety company." At the request of the indemnitors a writ of error was sued out and an appeal perfected and the case set for hearing in the United States circuit court of appeals. Before that time

[1] 104 Fed. 634.

the "surety company" paid the judgment in full and dismissed the appeal. On this state of facts the court spoke as follows: "The object and purpose of this notice undoubtedly was to make the judgment which might be rendered in the original case conclusive of the liability of the indemnitors under their bond. It is well settled that to accomplish that purpose the indemnitors must not only have the notice, but must be afforded a full opportunity to defend the action." It was further said, that the right to appeal was a valuable right that belonged to the indemnitors under the circumstances, and that the effect of the "surety's company" action in paying the judgment and dismissing the appeal was to discharge the indemnitors from their obligations as such to the "surety company."

Again it should be observed, that the right of subrogation can never be enforced in favor of a mere volunteer.[1]

It has been said that a surety company issuing a contract insurance bond, may, by permitting the "risk" to make such default as he pleases, insist upon its strict legal right, and in an action to enforce its liability legally interpose any defence that it may have. But when the surety company, in pursuance of the term of an undertaking, assumes the performance of the "risk's" contract, it, by being subrogated to the rights of the "risk" thereunder, must necessarily become subject to all his liabilities.[2]

§ 283. **The Right of Subrogation in Judicial Insurance.** — There is no possible room for questioning the privilege of the insurer issuing a judicial insurance bond to enforce the right of subrogation to the fullest extent as against the "risk" named therein, upon settlement with the insured of a legal liability incurred thereunder.[3]

[1] Henningsen *v.* U. S. Fid. & Guar. Co., 208 U. S. 404.

[2] Ausplund *v.* Ætna Indemn. Co., 47 Ore. 10; 81 Pac. 577.

[3] See Farmers' & Traders' Bank *v.* Fid. & Dep. Co., 56 S. W. 671; 108 Ky. 384; Myers *v.* Miller, 45 W. Va. 595; Am. Sur. Co. *v.* McDermott, 25 N. Y. Sup. 467; 5 N. Y. Misc. 298; Am. Sur. Co. *v.* Crow, *et al.*, 49 N. Y. Sup. 946; 22 N. Y. Misc. 573; 17 N. Y. App.

In Fidelity and Deposit Company of Maryland *v.* Haines, *et al.*,[1] the court, expressly recognizing the fact that statutory insurance bonds are contracts of indemnity, held that the insurer which issues such bond is entitled, in case it is sued thereon, to be subrogated to the rights of the "risk," to the extent of availing itself of the defences which would be open to the latter in an action brought by the insured against such "risk."[2]

The right of subrogation exists to the fullest extent in favor of the insurer who has been compelled to meet an obligation on the bond given in the course of judicial administration affecting trust estates. The case here presented is even stronger than is represented in fidelity bonds, in that it relates to estates under the care of the courts.[3]

In Farmers and Traders Bank *v.* Fidelity and Deposit Company of Maryland[4] it was held that an insurer on an administration bond who has been compelled to account for a trustee's defalcation is entitled to be subrogated to the rights

Div. 634; Milbank *v.* Am. Sur. Co., 43 N. Y. Sup. 474; People *ex rel.* Sur. Co. *v.* Anthony, 7 N. Y. App. Div. 132; Lesster *v.* Law. Sur. Co., 63 N. Y. Sup. 804; 50 N. Y. App. Div. 181; Am. Sur. Co. *v.* Thurber, 30 N. Y. St. Rep. 489; Smith *v.* Nat. Sur. Co., 28 N. Y. Misc. 628; Law. Sur. Co. *v.* Reinach, 25 N. Y. Misc. 150; Dunne *v.* Am. Sur. Co., 43 N. Y. App. Div. 91; Bacon *v.* Am. Sur. Co., 53 N. Y. App. Div. 150; Feinburg *v.* Am. Sur. Co., 33 N. Y. Misc. Rep. 458; Am. Sur. Co. *v.* McQuire, *et al.*, 103 N. Y. Sup. 753; Browne, *et al.* *v.* Fid. & Dep. Co., 98 Tex. 55; 80 S. W. 593; Am. Nat. Bank *v.* Fid. & Dep. Co., 129 Ga. 126; Fid. & Dep. Co. *v.* Bowen, *et al.*, Ia. ; 98 N. W. 897; Shea *v.* F. & C. Co., 83 N. Y. App. Div. 305; Cavines *v.* Fid. Co., 140 N. C. 58; 52 S. E. 625; Am. Sur. Co. *v.* Boyle, *et al.*, 65 O. 486; Tidd *v.* Block, 26 O. Cir. 113; City Tr. Safe Dep. & Sur. Co. *v.* Hoastlocher, *et al.*, 91 N. Y. Sup. 1022; 101 N. Y. App. Div. 415; Brown, *et al.* *v.* Fid. & Dep. Co., Tex. Ct. of Civ. App. ; 76 S. W. 944; City Tr. Safe Dep. & Sur. Co. *v.* Am. Brewing Co., 88 N. Y. App. Div. 383; City Tr. Co. *v.* Am. Brewing Co., 70 N. Y. App. Div. 511.

[1] 78 Md. 454; 28 Atl. Rep. 393.

[2] See Milbank *v.* Am. Sur. Co., 14 N. Y. App. Div. 250; Bacon *v.* Am. Sur. Co., 53 N. Y. App. Div. 150; Am. Sur. Co. *v.* Thurber, 21 N. Y. St. Rep. 489; Fid. & Dep. Co. *v.* Singer, 50 Atl. 518.

[3] Alexander *v.* Fid. & Dep. Co., Md. ; 70 Atl. 209; Am. Bond. Co. *v.* Nat. Mech. Bank, 97 Md. 598; 55 Atl. 396.

[4] 56 S. W. 671; 108 Ky. 384.

of the *cestui que trust* against one who has wrongfully appropriated part of the trust estate.

It is a general doctrine in equity that a surety who has discharged the debt is entitled to stand in the shoes of the creditor as to all liens securing the debt. This doctrine of subrogation, however, being an equitable one, is only enforced to accomplish the ends of substantial justice.[1]

A most instructive case on such right of subrogation is that of People *ex rel.* Lawyers' Surety Co. *v.* Anthony.[2] In this case the Lawyers' Surety Company had issued an administration bond upon one Anthony as receiver of an insolvent corporation. Anthony was discharged by order of the court, and at the time of his discharge was directed to pay over to his successor certain amounts of cash which had come into his possession as receiver. This he failed to do, and the Lawyers' Surety Company was called upon to pay the amount by reason of its issuance of the administration bond on Anthony as receiver. This payment was made by the Lawyers' Surety Company pursuant to an order of the court authorizing the substituted receiver to receive payments of the amount of the deficiency of Anthony from the "surety company," and upon receipt thereof to assign, transfer, and set over to the latter all his rights against the said receiver, so that the "surety company" should be subrogated to the rights of the substituted receiver. After satisfying the liability of Anthony, the "surety company" signed a demand for the payment of the sum so paid, and this was served upon Anthony, together with certified copies of the orders and papers upon which the demand was based. Anthony failed to comply with this demand, and an application was made by the "surety company" directing the issuance of a warrant of attachment as for contempt, which order was duly granted and the warrant of attachment was issued thereon. Anthony was arrested, and subsequent to his arrest filed an affidavit, in no way denying

[1] Continental Tr. Co. *v.* Am. Sur. Co., 80 Fed. 480; 25 C. C. A. 364.
[2] 7 N. Y. App. Div. 132.

the facts herein set forth, but alleged that he had taken an appeal from the order fixing the amount of his liability, and that upon such appeal he verily believed that said order would be reversed entirely or so modified as to reduce his liability many thousands of dollars. The receiver assigned to the "surety company" all his claims under said order, with the intention, as was stated, of subrogating the surety in his place and stead in respect to said order. It was argued that because of the use of these words there was no subrogation, and that the substituted receiver did not actually subrogate the "surety company" in its place and stead, but only said that he intended by the assignment so to do. This contention was overruled, the court holding that the "surety company" having, under the circumstances disclosed, paid the amount required to be paid by the "risk," and the decree being assigned to it under the authority of the court by its officer, succeeded necessarily to all the rights which the receiver had, and was entitled to pursue the same remedies as the receiver had for the enforcement of the decree.

It was held in Smith *v.* Surety Company [1] that where the insurer on a statutory insurance bond given by a "risk," who was one of two joint debtors for the payment of a debt, is compelled to pay such debt in full, he is entitled upon equitable principles to be subrogated to all rights of the creditor against all the joint debtors. It is a "well-settled rule," observed the court in this case,

"that where the relation of principal and surety exists, the creditor must preserve unimpaired all his rights against the debtor where he intends to look to the surety for payment. This obligation springs from the right of subrogation established by law in favor of the surety who pays the debt of his principal, and if the creditor fail to comply with this obligation, or destroy or impair the right of subrogation to the judgment and securities, the surety will be released. It is a familiar principle of law that a surety who pays a debt for his principal is entitled to be put in the place of the creditor, and to avail himself of every means

[1] 28 N. Y. Misc. 628.

that the creditor had to enforcé payment against the principal debtor. The doctrine of subrogation is frequently applied in cases where the person advancing money to pay the debt of a third party stands in the situation of a surety, or is only secondarily liable for the debt. It is also applicable to cases where the debtor is compelled to pay the debt of a third person to protect his own rights or to save his own property. Subrogation is not founded upon contract, but upon principles of equity, and may be enforced where no contract or privity of any kind exists between the parties. It has been repeatedly held that whenever one not a mere volunteer pays and discharges the debt of another, he is entitled to all the remedies which the creditor possessed against the debtor. . . . The rule seems to be well settled that a surety after paying off a debt shall stand in the place of the creditor and have all the rights which he has for the purpose of obtaining his reimbursement. He will be entitled to every remedy which the creditor has against the principal debtor to enforce every security and all means of payment, to stand in the place of the creditor not only through the medium of a contract, but even by means of securities or contracts entered into without the knowledge of the surety, having a right to have those securities transferred to him, though there was no stipulation for that, to avail himself of all those securities against the debtor, and it is immaterial by what means the security is created."

Again, the insured has no legal authority to question the right of the insurer to the securities in the former's hands applicable to the payment of the obligations which the insured has compelled the insurer to pay. It is immaterial, so far as such insured is concerned, what the legal rights are between the "risk" and the "insurer." The insured is not called upon to set up a defence for the benefit of the "risk" as against the insurer, nor to litigate their rights. It is sufficient, so far as the insured's rights are concerned, if he receives from the insurer payment in full of his claim against the "risk." When the "risk" has had an opportunity to be heard he may feel that he is legally and morally obligated to reimburse the insurer, who has paid money in the belief that there was a legal obligation on its part so to do, and he may not object for this reason to the enforcement of the securities

in the hands of the insured by the insurer. Before the insurer can demand and enforce an assignment of securities or enforce the rights of subrogation it must first have settled the "risk's" obligations in full.[1]

Bail in criminal cases are entitled to subrogation to the means of enforcing the performance of the thing which the recognizance of bail is intended to secure the performance of. This right of subrogation, however, does not extend to the peculiar remedies which the government may have for collecting a penalty.[2]

§ 284. **The Right of Contribution.** — The equitable right of contribution exists where several parties become surety for the same debt or obligation, and one of the sureties is compelled to pay the entire debt for which each of the other sureties is equally liable. In such cases, equity gives to the surety who has paid the debt or satisfied the obligation a right of action against the other sureties, — termed the right of contribution, — compelling them to pay their *pro rata* share of the amount paid by the first surety in settlement of such debt or obligation. Contribution may be said to rest upon the assumption that the equities of the several parties are equal.[3] That the right of contribution exists in favor of the compensated, to the same extent that it did in favor of the gratuitous surety, admits of no possible doubt and such right has been sustained in a number of cases. Thus it has been held that co-sureties on successive fidelity bonds given by a city marshal to the public (though not cognizant of the existence of each other) are entitled to contribution from each other in the absence of equities as between themselves.[4]

[1] Smith *v.* Nat. Sur. Co., 28 N. Y. Misc. 628; see also Am. Sur. Co. *v.* McDermott, 25 N. Y. Sup. 467; 5 N. Y. Misc. 298; Am. Sur. Co. *v.* Crow, *et al.*, 49 N. Y. Sup. 946; 22 N. Y. Misc. 573; Milbank *v.* Am. Sur. Co., 43 N. Y. Sup. 474.

[2] U. S. *v.* Ryder, *et al.*, 110 U. S. 308.

[3] Fid. & Dep. Co. *v.* Bowen, *et al.*, Ia. ; 98 N. W. 897.

[4] See also Fid. & Dep. Co. *v.* Bowen, *et al.*, Ia. ; 98 N. W. 897; Matter of Fid. & Dep. Co. *v.* Stevens, 87 N. Y. App. Div. 609; affirmed in 177 N. Y. 555; Nat. Sur. Co., *et al.* *v.* Button, Ind. ; 83 N. E. 644; Carter *v.*

As bearing upon the general subject of the right of contribution in guaranty insurance, attention is called to the case of Fidelity and Deposit Company of Maryland *v.* Bowen, *et al.*[1] In this case the court spoke as follows:

"In regard to this question of the superiority of equities which is liable to arise in the case of prior and subsequent bonds executed by different sureties for distinct purposes and both constituting securities in the hands of the creditor for the same debt, it is well settled that, if the interposition of the second surety is for the benefit of the principal alone, without the sanction of the first surety who may be prejudiced thereby — as when the effect of the second bond is to prevent the enforcement of present payment from the principal thus to prolong the responsibility of the first surety — in such a case the equity of the first surety is superior and he is entitled to be subrogated to the rights of the creditor as against the second. This doctrine seems to be entirely equitable, for it is but reasonable that the benefit for the principal alone by the second surety should be conferred, if at all, at his own risk, and not at the risk or to the prejudice of other parties whose wishes were not consulted in the transaction. But the rule is otherwise where the surety in the second bond is for a purpose for which the prior surety is expressly given which is clearly to be inferred from the circumstances of the case. But in such a case the last surety has the right to look for indemnity not only to his principal, but to such fixed securities as have been given to the creditor when the engagement was entered into and on the faith of which he may have been presumed to have incurred his obligation."

Next attention is called to the case of Kolb *v.* National Surety Company, *et al.*[2] The facts in this case briefly stated were as follows: A surety company paid a debt on a judgment recovered in tort against several defendants for one of whom it was surety on appeal from the judgment. By an order of the court it was subrogated to all the rights and securities of the judgment creditor, including those under contract by

Fid. & Dep. Co., 134 Ala. 369; 32 Sou. 632; Nat. Sur. Co. *v.* Di Marsisco, 105 N. Y. Sup. 272; McDowell County Commissioners *v.* Nichols, *et al.*, 131 N. C. 501; 42 S. E. 938; Bomberg *v.* Fid. & Dep. Co., Ala. ; 36 Sou. 622; Moore, *et al.* *v.* State *ex rel.* Ferguson, Ind. ; 84 N. E. 161.

[1] Ia. ; 98 N. W. 897.

[2] 176 N. Y. 233; 68 N. E. 249.

which a judgment debtor agreed to pay a certain sum on the determination of the case, on payment of which he was to be released from liability. After recovery of a judgment in tort, upon appeal one of the judgment debtors agreed with the judgment creditor to pay a certain sum in consideration of his release from judgment. The surety company paid the judgment in full and thereby became subrogated to the rights of the judgment creditor thereunder. Under the foregoing state of facts the court held, first, that the surety company was entitled to collect the amount of the judgment against the debtor by a proper application of the doctrine of subrogation. The court further held that if after recovery of a judgment in tort upon appeal one of the judgment debtors sees fit to agree with the judgment creditor to pay a certain sum in consideration of his release from the judgment, the surety company which had paid such judgment in full thereby became subrogated to the rights of the judgment creditor therein. It was further held, that the judgment creditor could not be released from his agreement on the ground that the surety company had released another judgment debtor in consideration of the payment of the latter's share of the judgment where under said agreement there was refraining of the right to enforce the judgment against the other debtor. Equity, it is said, will not relieve a judgment debtor under a judgment in tort from levy of execution to enforce his agreement to pay a certain sum on the judgment in consideration of his release therefrom, thereby assisting him to violate his express agreement. The court in its opinion in this case spoke as follows:

"The general proposition is true that there is no right of contribution as between wrong-doers which can be enforced; for a court of equity, which alone would have jurisdiction of such an action, will refuse to lend its aid to those who have been guilty of illegal conduct or who do not come before it with clean hands. The legal principle upon which contribution among those jointly indebted rests, is as just when wrong-doers are concerned, as in other cases where it is allowed, and the refusal of a court to entertain an action to compel it is based upon considerations of the nature of the complainant's liability and

the association of the parties who incurred it. That this doctrine of equity would or should exclude from relief a surety, who like this respondent, has been decreed by the court to be entitled to be subrogated to the rights and remedies of the judgment creditor and is in effect in the position of a purchaser from the latter of the judgment, I do not believe. If there is a precedent I do not find it for such extreme application of the doctrine. In the first place a surety who pays a debt is, by the well-settled law of the land, entitled to stand in the shoes of the creditor, or to be subrogated to all of his rights, remedies and securities with respect to any fund or lien; not upon any contractual basis, but upon established principles of equity, or as said by Chancellor Kent in Chessebrough *v.* Millard,[1] 'on mere equity and benevolence.'

"In the second place the surety in this case does not come within the reprobation of the court in any aspect; for the principle of equal contribution being a just one, even as between wrong-doers, and the denial of its recognition resting upon especial grounds, which would be peculiar to the complainant in the bill for equitable relief, this surety is not embarrassed by asking for that which the court had in the Adwen proceeding accorded to it. It is innocent of any wrong doing. That it has paid an indebtedness arising upon a judgment in tort against several for one of the judgment debtors, should not, as a matter of natural justice, deprive it of the right, approved as it is by a decree of the court, to compel the joint debtors to contribute proportionately to the payment of the judgment now its property. The right of subrogation is founded in natural justice, and it should be given effect upon purely equitable considerations."

A bill for contribution by a surety on the bond of a public officer against the sureties on other bonds given April 10, alleging that the officer defaulted on July 12, was not demurrable for failure to allege that the officer had converted money subsequent to April 10, but if the default occurred before the execution of defendant's bond, that was a matter of defence only.[2]

Where a surety on the bond of a public officer has been held liable in a suit on the bond, and sued the sureties on another bond for contribution, alleging that such other bond was required by statute, and that the bond was acted under by the

[1] 1 Johns, c. 412.

[2] Carter *v.* Fid. & Dep. Co., 34 Ala. 369; 32 Sou. 632.

officer, a demurrer on the ground that it was not a statutory bond, was held without ground under Alabama Code [1] declaring that whenever any officer required by law to give an official bond acts under a bond, which is not in the penalty payable, and conditioned or without sureties of requisite qualifications as prescribed by law, such bond is valid and binding upon the obligor. Where the surety on the bond of a public officer was held liable thereon, and brought suit against the sureties on other bonds for contribution, and a part of such sureties paid defendant their proportion, a dismissal as to them could not be objected to by other defendants, as their liability was not thereby increased.[2]

Where the surety on the bond of a public officer has been held liable thereon, his right to contribution from the sureties on other bonds is not limited to the actual default of the officer, to the exclusion of the costs of defending the suit on the bond, the defense not being frivolous or unnecessary.[3] In making the foregoing hold, the Alabama Supreme Court spoke as follows:

"If a creditor having a claim against several securities may select of the one he wishes to sue, and the one sued is limited in his right of contribution to the actual default of the principal, exclusive of the costs of suit, he can by his selection to the extent of the costs of the suit, make a victim of the surety sued, and thus make the common burden personal oppression. We think the true rule is that where the surety obtains any advantage from the suit, or where, although resistance of the suit was unsuccessful, there was reasonable grounds of defence, if he acted as a prudent man would in the light of the facts and circumstances showing a probability of success in whole or in part, the surety sued should be entitled to include the costs and damages of the suit in his claim for contribution against his co-sureties. His co-sureties ought not and cannot complain, for the burden of paying the debt rested equally upon them, and they could have prevented suit, or even stopped it after its commencement by paying the demand of the creditor. The extra liability for the costs and damages of suit, not frivolously nor needlessly defended, should not

[1] § 3089. [2] Carter *v.* Fid. & Dep. Co. of Md., 134 Ala. 369; 32 Sou. 632.
[3] *Ibid.*

be imposed upon one of several equally bound at the caprice of the common creditor, any more than the payment of the debt itself." [1]

It seems that an extension of time given by the insured to a party liable on an indemnifying bond as a co-insurer will not discharge the other co-insurer where the latter is not in any manner prejudiced by the extension. Where time is given to the "risk" without the consent of the insurer, the latter may be discharged, but the mere giving of time to the co-insurer whose obligation is equal will not discharge the other if not prejudiced thereby.[2]

Where the insurer grants an indemnity policy to one of three sureties upon an official bond, and thereafter brings an action against all of them to enforce an alleged right of indemnity, such insurer has no right to compel contribution against the other two sureties in its favor, even where the surety to whom the policy was issued makes a formal assignment of such right to the insurer by whom the indemnity was furnished. This for the reason that the law holds the insurer's indemnity policy in trust for the other sureties.[3]

The right of the insurer to seek full indemnity from one or several "risks" against each of whom the right of subrogation exists in his favor, is not affected by any agreement between such "risks" to which the insurer was not a party, and the insurer has the right to release any one of the "risks" from the whole or a part of their liability to indemnify it without affecting its right to enforce indemnity from the balance of such "risks." [4]

In Fidelity and Casualty Company *v.* O'Brien, *et al.*,[5] it appeared that in a suit against an insurer on a bond given by a corporate officer, where the defalcation of the latter had mostly occurred under a prior bond on which suit was also pending, and the sureties on the prior bond (private) learning

[1] Carter *v.* Fid. & Dep. Co. of Md., 134 Ala. 369; 32 Sou. 622.

[2] Am. Sur. Co. *v.* Crow, *et al.*, 37 N. Y. App. Div. 634.

[3] Gibson, *et al.* *v.* Shean, *et al.*, 28 L. R. A. 400; 5 Ct. of App. D. C. 391.

[4] Am. Sur. Co. *v.* Thurber, 121 N. Y. 655; 30 N. Y. St. Rep. 489.

[5] Tenn. ; 38 S. W. 417.

of the testimony in the other case (on the "surety company" bond), had effected a compromise of their suit by agreeing that a judgment should be entered against them for $25,000, instead of $30,000 (the amount of the bond) and that execution should be held up for six months, that defendant should pay $5000 cash, that certain trust deeds given by the "risk" for their benefit should be foreclosed and that if they should purchase property the "surety company" should buy it from them for $25,000, and credit that amount in full satisfaction of the balance of the judgment, it was held that such compromise was not such a fraud on the "surety company" in the other suit, as would estop the sureties on the prior bond from claiming their rights under the deeds of trust.[1]

At this point attention is called to some few cases not bearing directly on the immediate subject now under consideration, but so closely connected with it as to justify reference thereto.

The general subject of co-insurance is considered at length in City Trust Company *v.* Fidelity and Casualty Company of New York.[2] It was held that where the insurance policy provided that the insurer therein named should reimburse the insured therein for losses occurring under the terms of the policy at the expiration of three months next after proof of said losses had been made, the fact that the insurer settled such losses prior to the expiration of the period named, did not deprive the insurer of the right to enforce the policy of reinsurance. The court construed such a provision as an option, given the insurer for its own protection merely, and that wherever it saw that a legal liability had been incurred, it was at liberty to disregard such time limit; but the court, however, held, by implication at least, that if notice of claim of loss and of payment thereof is required by the conditions of the insurance policy, such conditions must be complied with in order to enforce the reinsurer's liability under such policy.

[1] The trust deeds here referred to were for the benefit of both sets of sureties, and it was claimed that they should share and share alike with the private bondsmen; see also Bubb, *et al.* *v.* Am. Bond. & Tr. Co., 30 Pittsburg L. J. 361.

[2] 58 N. Y. App. Div. 18.

There is no question as to the right of fidelity insurance companies to secure themselves, if they see fit to do so, by taking counter-security from the "risk."[1] The right to retain such collateral security, however, may be impaired by reason of latent equities existing in favor of a third party.[2]

One about to become surety with others can stipulate with the principal without the knowledge of the other sureties, for a separate indemnity for his own benefit, under which, in the absence of fraud, or unless it was intended for the benefit of all, the others cannot participate until he is reimbursed.[3]

§ 285. **Exoneration in Guaranty Insurance.** — The entire subject of exoneration in guaranty insurance is fully considered in another chapter of the present work under the title of "Mutual Rights and Obligations as Between the Insurer and the "Risk."[4] There will be presented here a brief discussion of both the common law and equitable principles of exoneration under the respective heads of "Exoneration in Law" and "Exoneration in Equity."

§ 286. **Exoneration in Law.** — The surety's right to be exonerated in courts of law rests upon the theory of an implied contract. This contract the principal is supposed to assent to by requesting the surety to assume the liability, and it therefore may be regarded as created with the creation of the debt. Yet the mere default of the principal and the consequent liability of the surety to pay the debt are not sufficient to sustain an action against the principal. The contract is not regarded as broken for the purposes of enforcing the surety's rights until he pays the debt in whole or in part payment, and the proportionate discharge of the principal from the claims of the creditor are therefore conditions precedent.

[1] See March *v.* Fid. & Dep. Co., 79 Md. 309; 29 Atl. 521; F. & C. Co. *v.* Lawler, 64 Minn. 170; Union Sur. & Guar. Co. *v.* Sire, 34 N. Y. Misc. Rep. 220.

[2] Milbank *v.* Am. Sur. Co., 14 App. Div. 250; Guar. Co. of N. A. *v.* East Rome Town Co., 23 S. E. 503.

[3] McDowell County Commissioners *v.* Nichols, *et al.*, 131 N. C. 501; 42 S. E. 938.

[4] See *post*, Part VII, Chap. XXIII.

But the surety is not bound to wait until suit is brought against him, nor is the debtor's request necessary to entitle him to his action. Being bound by his contract to pay, performance of this contract can in no sense be considered voluntary.

This action being in assumpsit for money paid, it is not entire and indivisible. It is not indispensable, therefore, that the surety pay the whole debt, or that the whole debt be discharged before he will be allowed his action. As soon as he pays everything upon the debt he may sue the principal, and for each successive instalment that he pays he has his action. The doctrine of the common law against the apportionment of causes of action seems not to be applicable, as the surety's cause of action is for money paid without reference to the amount of the claim for which he is surety. The implied contract of the principal to indemnify the surety for all loss he may sustain on account of the obligation is not the contract to the creditor, " nor is the creditor's cause of action the surety's cause of action." It may be said that to compel the surety to wait until the whole debt is extinguished or oblige him first to discharge it before bringing suit, might, by the delay, work injury to his affairs. Manifestly, also, it being primarily the duty of the principal to pay the debt, he ought not to object if by his own default he subjects himself to successive suits.

It is important to consider briefly what constitutes payment by the surety so as to entitle him to his cause of action. In general it may be said, unless he part with something of value, even though the debt be discharged, he has no cause of action. Payment, therefore, in land or goods, if accepted in satisfaction by the creditor, would sustain the action. The cases are clear that the transfer of the surety's bond would not be payment within the rule. It is not money, and the surety parts with nothing but a promise. But a different and anomalous result is reached by the authorities when the surety gives his own negotiable paper in payment, and it

is expressly accepted by the creditor as such. Though ordinarily regarded but as a means of payment, it is held in this case to be payment *sub modo* for the purposes of the surety's action. The reasons of the rule are not entirely satisfactory, for the question is not whether the principal is relieved, but whether the surety has sustained a loss. If it be argued that the liability of the surety is made more certain, it may be said that this would be still more true in case of payment by a bond which, as we have seen, none of the courts regard as payment. Also, as has been shown, the theories of law do not admit the mere liability of the surety as an adequate reason for redress. Neither is negotiable paper the same as cash, though possessing some of the attributes of the latter. Many decisions base the doctrine upon grounds of expediency, alleging that the surety might be compelled to pay the debt twice were the note transferred to an innocent holder for value. It appears on the whole to be a departure from strict legal principles and an attempt to give effect to the equitable nature of contract of suretyship. The rule seems to prevail almost uniformly in the United States, though the authorities in England are apparently in doubt.

Exoneration in courts of law may therefore be regarded as the mere transfer of the burden of the obligation from the surety to the principal. In many instances just and sufficient, it is manifestly unable to give the proper relief where the principal is threatened with insolvency or the element of fraud enters into his transactions. It can only give redress for past losses, and has no power to protect against future damages. Frequently, also, the number of obligors and obligees renders the proceedings at law complicated and full of delay. For these reasons the parties are often forced into equity, and the rights of the surety against the principal in this court will now be considered.

§ 287. **Exoneration in Equity.** — As the right of exoneration was originally equitable, even if the remedies of the surety were complete at law, equity would still retain jurisdiction

in accordance with a familiar principle. In addition to the reasons given above for equitable jurisdiction in matters of suretyship, the light in which the relation of principal and surety is regarded in equity, renders the surety's resort to this court particularly appropriate. While at law the surety is looked upon as a mere contingent creditor of the principal, with no standing in court before payment of the debt in whole or in part, in equity the relation is considered as fiduciary from the beginning. From this distinction of theory flow many important results in the remedies given. While in law the surety is confined to his implied contract, in equity relief is readily granted the surety whenever the trust relation is abused. In law a consideration is a condition precedent to relief, but in equity the mere liability of the surety is often sufficient to set the court in motion. For as it has been well expressed, " In equity a person entitled to be indemnified is not bound to wait until he has suffered and perhaps been ruined before having recourse to judicial aid." The surety may therefore appeal to equity before payment as well as after. This furnishes a convenient basis for the discussion of the remedies given.

1. *Relief before payment.* — Immediately upon the default of the principal the surety may file a bill in equity in the nature of a *quia timet* against the principal to compel him to pay the debt and relieve the surety from liability. It is granted at any time after the debt has fallen due. Such relief was known early in equity, for at the time of Lord Keeper North we find the court decreeing that such a bill would lie in favor of a surety, " it being unreasonable that a man should always have a cloud hang over him." Employed in general in those cases where the creditor might proceed against the principal but neglects to do so, it becomes especially serviceable as a protection against fraud and collusion. In its results it may be compared to the remedy of specific performance, for the principal is compelled to execute literally his obligation. When applicable it is the most effective of all the surety's

agencies of redress, for it not only secures his present rights, but the form of a decree is sometimes framed to guard against anticipated violations. It is competent for the surety to make the creditor a party in order to avail himself of the remedies of the latter if necessary.

Though strictly not a part of a subject which concerns the rights of the surety against the principal, the right of the surety to go into equity to compel the application of securities to the discharge of the debt out of funds set apart for that purpose must be noticed. The general rule is that the surety has no right to control the creditor's action in respect to such securities, but the creditor has his option, whether or not he will resort to these. The obvious reason is that the surety by payment of the debt would have the right to be subrogated to these securities. This would not, however, prevent the court from modifying its procedure, when, owing to the peculiar nature of the fund the surety could not be subrogated to the rights of the creditor. In such a case the surety has a special equity which the court will enforce by a species of marshalling. The same doctrine is applied where two funds are in court, one belonging to the surety, the other to the principal. Particular contracts of suretyship such as guaranties of collection might change the rule, but the general doctrine is as stated.

2. *Relief after payment.* — Equity has original jurisdiction to compel the principal to indemnify the surety upon payment. This remedy in modern times is in general used as incidental to some other equity which has brought the parties before the court. Yet independent suits for reimbursement are entertained. Incidental to this the surety may also on payment of the debt file a creditor's bill in equity to set aside fraudulent conveyances. The fiduciary character of the relation of principal and surety will not admit of the semblance of unfairness on the part of the principal and conveyances made before the principal's default are within the rule.

PART VII.—MUTUAL RIGHTS AND OBLIGATIONS AS BETWEEN THE INSURER AND THE RISK

CHAPTER XXIII

MUTUAL RIGHTS AND OBLIGATIONS AS BETWEEN THE INSURER AND THE "RISK"

§ 288. **General Remarks on the Mutual Rights and Obligations of the Insurer and the "Risk."** — The respective rights of the insurer, insured, and the "risk" in guaranty insurance, in relation to each other, are governed by diverse rules and constitute different legal relationships. The relationship of the insurer to the insured is governed in nearly all departments of guaranty insurance by the general principles of insurance law. The relationship of the "risk" to the insured is defined and controlled by the law of master and servant, principal and agent, trustee and *cestui que trust*, or guardian and ward, etc., as the case may be.

When one comes to consider the nature of the relationship that exists between the insurer and the "risk," some doubt may arise as to the exact nature of such relationship.[1]

Not infrequently the contention has been made that where the "risk" has signed the policy of insurance, this in itself makes him a party to the contract of insurance.[2] Such contention, however, is by no means sound. The purpose in

[1] See matter of Thurber, 43 App. Div. N. Y. 528; Guar. Co. of N. A. *v.* First Nat. Bank of Lynchburg, 95 Va. 480; 28 S. E. 909.

[2] See Guar. Co. of N. A. *v.* Mech. Sav. Bank & Tr. Co., 80 Fed. 766; 26 C. C. A. 146.

having the "risk" join with the insurer in executing the policy of insurance is that he may in this formal manner enter into certain definite obligations with the insurer looking to the latter's indemnification in case of payment of loss to the insured. In other words, the act of the "risk," in subscribing his name to the policy, is to be construed, not as making him a party to the contract of insurance, but merely as evidencing his consent to the terms, and his agreement to indemnify the insurer in case of loss.[1] The real nature of the "risk's" relation to the insurer is pointed out in Rice *v.* Fidelity and Deposit Company,[2] where the court, in construing an insurance policy, made use of these words:

"The complaint alleges, and the fact was, that the plaintiff (the insured) made an agreement of employment with Perry (the 'risk'), at the time this policy was made, under which he was liable to them for the losses which they claim to have sustained under his dishonest and fraudulent acts. The policy in suit recited this employment, and gave to the plaintiffs further indemnity to the amount of $10,000 against these losses. The legal effect of this contract was to create the relation of principal and surety between Perry and the fidelity company."[3]

The legal relationship existing between the "risk" and the insurer being thus ascertained, it then becomes pertinent to inquire just what are the mutual rights and obligations of the two, growing out of the concurrent obligations of the insurer to the insured under the contract of insurance entered into by the former with the latter at the request of the "risk."[4]

§ 289. **Rights of the "Risk" as against the Insurer.** — It is not essential to the validity of the contract as between the

[1] Am. Bond. & Tr. Co. *v.* Milwaukee Har. Co., 91 Md. 733; 48 Atl. Rep. 72; see, however, First Nat. Bank *v.* School Dist. No. 1, Neb. ; 110 N. W. 349.

[2] 103 Fed. 427; 43 C. C. A. 270.

[3] See to the same effect, Guar. Co. of N. A. *v.* Geddes, 22 Fed. 639; Feinberg *v.* Am. Sur. Co., *et al.*, 33 N. Y. Misc. 458.

[4] See generally on rights between the risk and the insurer, City Tr. Co. *v.* F. & C. Co., 58 N. Y. App. Div. 18; Am. Sur. Co. *v.* McDermott, 5 N. Y. Misc. 298; 9 N. Y. Misc. 132; Am. Bond. & Tr. Co. *v.* U. S., 15 App. D. C. 397.

insurer and the insured, that the policy should have been issued either at the express or implied request of the "risk." It is, however, a matter of almost universal practice to have the request for the issuance of the indemnity policy proceed from the "risk" as a necessary preliminary to the issuance of the policy of insurance. In view of the necessity of the existence of a contract relationship between the insured and the "risk" as a basis for the issuance of a valid policy of guaranty insurance, such relationship must always exist in order to furnish the requisite insurable interest. Now in view of the fact that the issuance of such a policy is almost universally preceded by a request for the same made by the "risk" to the insurer, thereby creating a legal obligation on the part of such "risk" to reimburse the insurer in case of loss, it would seem to be a necessary result of this that the former should have some rights arising out of his relationship as principal to the latter which must be recognized, if the insurer is to retain its right to demand reimbursement from the "risk" under the latter's indemnity agreement with the former. This on the theory that inasmuch as he has assumed the obligation of reimbursing the insurer for all losses arising on the policy through his conduct, he should know the full extent of such obligation and have a reasonable opportunity to make good any loss to his employer covered by the policy, in the first instance, before recourse is had to enforcing the insurer's liability thereunder.[1] Let us now examine and see to what extent, if at all, such rights exist. We will consider

[1] See generally as to the respective rights and obligations of the "risk" to the insured the following cases: *In re* Denton's Estate, L. R. Ch. Div. 1904, 178; *In re* Am. Fid. Co., examination of White, 104 N. Y. Sup. 711; City Tr. Safe Dep. & Sur. Co. *v.* Am. Brewing Co., 174 N. Y. 486; Thomson *v.* Am. Sur. Co., 170 N. Y. 111; 8 Bedell 994; Moore, *et al.* *v.* State *ex rel.* Ferguson, *et al.*, Ind. ; 84 N. E. 161; Am. Nat. Bank *v.* Fid. & Dep. Co., 129 Ga. 126; Am. Sur. Co. *v.* Lehr, Tex. ; 93 S. W. 681; Roberts *v.* Am. Bond. & Tr. Co., 83 Ill. App. Ct. 463; Bateman Bros. *v.* Am. Sur. Co. of N. Y., *et al.*, Cal. ; 78 Pac. 734; First Nat. Bank *v.* School Dist. No. 1, Neb. ; 110 N. W. 349.

these rights as arising out of the "risk's" express or implied promise to indemnify the insurer in case of liability being incurred on his account under the policy. These may be summarized as follows:

1. The right to a full knowledge of the terms and conditions of the policy issued upon him by the insurer to the insured.

It may be observed in passing that after a guaranty insurance bond has been issued at the request of the "risk" the latter is conclusively presumed to have read the policy and to know the contents thereof.[1]

2. Prompt and accurate information as to the nature of all claims made by the insured under the policy, so far as they may affect him, and his ultimate liability to the insurer.

3. Opportunity to investigate such claims, and to either explain or make settlement therefor.

4. The privilege of personal and continuous control over property entrusted to his care as contemplated when the policy was applied for, free from unconscionable interference therewith by the insured. In short, the right to say that so long as his responsibility exists, just so long must the "risk" be permitted to retain the same personal control over the insured's property that was contemplated when the policy was applied for.

5. The right to demand from the insurer the return of all counter-security held by the latter and belonging to the "risk" as soon as all claims under the policy itself shall have been cancelled or terminated.[2]

6. The right to be made either a party defendant with the insurer in an action brought against it by the insured to enforce the former's liability under the policy, or in lieu thereof to exercise the right at all stages of the proceeding to conduct, in conjunction with the insurer and with equal rights, the defence of such actions.[3]

[1] Ætna Indemn. Co. *v.* Ryan, 103 N. Y. Sup. 756.

[2] Shea *v.* F. & C. Co., 83 N. Y. App. Div. 305; 82 N. Y. Sup. 39.

[3] Nevins *v.* F. & C. Co., 66 N. Y. St. Rep. 674; Am. Sur. Co. *v.* Ballman, *et al.*, 104 Fed. 634; Feinburg *v.* Am. Sur. Co., 33 N. Y.

7. The right to demand an accounting with the insured whenever the "risk" is required to keep accounts by express direction of the insured.[1] In addition to the foregoing specifically enumerated rights there are, of course, others of which mention has not been made.[2] As bearing upon the subject now under consideration, attention is called to the case of American Bonding and Trust Company *v.* Takahashi, *et al.*[3] In this case the insurer had furnished a contract insurance bond to the insured (a railway corporation) conditioned upon the latter's being protected from claims for labor performed for the "risk," who was a contractor engaged in furnishing laborers to the insured in connection with some tunnel work undertaken by the latter. The agent of the insurer, at the time the "risk" applied for the bond, required that all moneys to become due from the insured to the "risk" under the executory contract then existing between them should be paid to such agent *as trustee* to be disbursed by him to the laborers. Pursuant to such requirement a clause was inserted in both the contract of the insured with the "risk," and in the bond furnished by the insurer to the insured, so providing. The agent failed to properly account for a part of the moneys paid over to him by the insured pursuant to said agreement, and thereupon the "risk" brought suit to recover the amount thereof from the insurer, on the theory that the agent, though named as trustee in the agreement and bond, was in fact the representative of the insurer alone. In this contention the "risk" was sustained both by the trial court and by the federal court of appeals for the ninth circuit.

In this same connection the case of Boyce *v.* United States Fidelity and Guaranty Company[4] is not without its bearing

Misc. Rep. 458; Lyman *v.* F. & C. Co., 65 N. Y. App. Div. 327; Ætna Indemn. Co. *v.* Ryan, 103 N. Y. Sup. 756; Am. Sur. Co. *v.* Lehr, Tex. ; 93 S. W. 681; Robb *v.* Secur. Tr. Co., 121 Fed. 460.

[1] See Warren *v.* Holbrook, 95 Mich. 185; 54 N. W. 712.

[2] See also McDowell County Commissioners *v.* Nichols, *et al.*, N. C. ; 42 S. E. 938; *In re* Am. Fid. Co., 104 N. Y. Sup. 711.

[3] 111 Fed. 125.

[4] 111 Fed. 138.

upon the question of the rights of the "risk" and the insurer *inter sese*. Here the "risk" had entered into a contract with the city of Cincinnati for public work, which not only fixed a time by which the work should be completed, but further provided that, if the "risk" should fail to commence or proceed with the work to the satisfaction of the insured, the latter should have the right, on notice, to declare the contract forfeited. As between the "risk" and the insurer — who furnished a contract insurance bond to the insured, insuring the faithful performance of the "risk's" contract with the insured — it was agreed that the former should indemnify the latter against any loss by reason of the "risk's" default, and that in case such default did occur, the insurer should be subrogated to his rights in the premises and might use the "risk's" property and equipment for the purpose of completing his work under the contract with the insured.

The insured declared that the progress of the work was not satisfactory and after due notice declared the contract forfeited and annulled. Afterwards the insured permitted the insurer to complete the work, in doing which the latter incurred a considerable expense above the price stipulated to be paid by the insured to the "risk" therefor.

Under the foregoing state of facts the federal court of appeals for the sixth circuit held as follows: That under the power given the insured by its contract with the "risk," its decision that the work was not proceeding satisfactorily was conclusive on the "risk," and authorized the insurer to assume charge of the work, and that the insurer thereby became a creditor of the "risk" for the amount of loss it sustained in completing the latter's contract with the insured, and entitled as such to maintain a petition against him in involuntary bankruptcy.

In this same case it was said that where a contract entered into with the insured by the "risk" for public work gives the former the power to terminate the same if not satisfied with the progress of such work in case of delay continued

after ten days' notice to the " risk," such notice is not required to contain a positive statement that a forfeiture would be declared, nor could the " risk " object that a forfeiture was declared within ten days after the notice was given, where, in the meantime, he had entirely abandoned the work.[1]

§ 290. **Rights of the Insurer against the " Risk " — The Right of Exoneration or Indemnification.** — The general subject of the right of exoneration both as it existed at common law and in equity has been briefly considered in preceding sections.[2] It now only remains to make a practical application of the broad principles there stated to the subject now before us.

In discussing the question as to the insurer's right to demand indemnification from the " risk " after payment of loss by it to the insured, reference is had, not to the exercise of the right of subrogation, but to the enforcement of a promise on the part of such " risk " to make good to the insurer any loss it might sustain by reason of issuing the policy of guaranty insurance to the insured. The " promise " here referred to may be either an express agreement to indemnify, or it may be implied by law by reason of the circumstances under which the policy was issued. Attention will be first called to the subject of the " risk's " express contract of indemnity. This is evidenced usually either by fit words to that effect inserted in the policy itself (which is then signed by the " risk " as well as the insurer) or else by the execution of a separate written contract of indemnity, signed only by the " risk." As has already been observed, the policy sometimes contains certain stipulations as to proof of loss between the insurer and the insured, to the effect that "a written statement of loss, certified to by the duly authorized officer of the insured, and based upon the accounts of the insured, shall be *prima facie* evidence of such loss."

Where such provisions are found in the policy, it is evident

[1] See generally U. S. Car Co. *v.* Bagley, 87 N. W. 1044.

[2] See *ante*, §§ 286–287.

that if they are to be held binding upon the "risk" in an action brought against him by the insurer, for the purpose of compelling indemnification, this would necessarily have an important bearing upon the manner and amount of proof necessary to establish such a right. Are such provisions then binding upon the "risk"? This question was answered by the Supreme Court of Minnesota[1] in substance as follows: Where the policy has been executed at the request of the "risk" and in the form requested by him, it follows that his obligation to the insurer is coextensive with that of the insurer to reimburse the insured; also that any provisions in the policy as to the proof of liability binding upon the insurer in favor of the insured are equally binding on the "risk" in an action brought by the insurer against him to recover indemnity for what it had paid in his behalf.[2]

To entitle the insurer to recover on an express promise of indemnity given it by the "risk," it is not necessary in the first instance to show that the indemnitor had the legal right to issue a counter-indemnity bond to the former. But if issue is made on this point, then it must be shown that the "risk" (if a corporation) had the right to issue such counter-indemnity.[3]

The general subject of indemnity, when preserved by an express contract, is discussed at length in American Surety Company *v.* Crow.[4] This was an action where the American Surety Company had furnished an appeal bond in consideration of the granting to it of a counter-indemnity bond, promising and agreeing to keep it indemnified from all loss, damages, etc., sustained by reason of the latter's execution of the said appeal bond. The American Surety Company was obliged to pay the full amount of the appeal bond, and brought an action against the signers of the counter-indemnity bond to recover the amount paid by it on the appeal bond. Crow,

[1] F. & C. Co. *v.* Eickhoff, 63 Minn. 170; 65 N. W. 351.

[2] See *post*, § 291.

[3] City Tr. Safe Dep. & Sur. Co. *v.* Wilson Mfg. Co., 58 N. Y. App. Div. 271.

[4] 22 N. Y. Misc. Rep. 573.

one of the signers of this counter-indemnity bond, defended in the action on the ground that it was agreed, as between the American Surety Company and himself, that the former would look for indemnity exclusively to Thurber, one of the signers of the counter-indemnity bond. On the merits of this defence, the court spoke as follows:

"While an instrument not under seal may be delivered upon condition, the observance of which is, as between the parties, essential to its validity, it is not permissible to show a contemporaneous parol agreement, inconsistent with that which is written and tending to nullify it. The indemnity bond was given to induce the surety company to become surety on the undertaking, and it was, therefore, induced to incur a liability indemnified against, so that the obligation is founded on valuable consideration. This obligation was not an ordinary court bond. If it had been, Crow (as attorney for the 'risk') might have been rejected by the court because of his relationship to the 'risk,' but where no such objection is made by the creditor, even the attorney may become liable." It was further contended by Crow that the American Surety Company settled all liability on the bond with Thurber, the co-surety, by accepting from him notes, stocks and securities, whereby Crow was discharged. Commenting on this defence, the court said: "Thurber gave a six months' note for the demand secured by the stock of the Hazard Company, which note, after the payment of six months' interest, was renewed by another at three months. But these promises to pay were not given or accepted in satisfaction, and were not, so to speak, unless followed by payment. They were unperformed, and nothing was realized from the stock. The broken promises to pay did not discharge the obligation sued upon.

"Where time is given to the principal debtor without the consent of the sureties, they may be discharged; but the mere giving of time to a co-surety whose obligation is equal will not discharge the others, if not prejudiced thereby. The acts of Thurber in further securing the American Surety Company in no manner prejudiced his co-surety, Crow, and did not discharge the liability of either on the bond." [1]

[1] See also Am. Sur. Co. *v.* Crow, *et al.*, 17 N. Y. App. Div. 634. See generally on the right to demand indemnity: March *v.* Fid. & Dep. Co., 79 Md. 309; 29 Atl. 521; Bubb *v.* Am. Bond. & Tr. Co., 30 Pittsburg L. J., 361; Am. Sur. Co. *v.* Lawrenceville Cem. Co., 96 Fed. 25; 110 Fed. 717; U. S. *v.* Am. Sur. Co., 110 Fed. 913; Parrs Bank *v.* Albert Mines Syndicate, 5 Com'l Cases, 116; Guarantor's Lia. Indemn. Co. *v.* Bank, 34 S. E. 950. See generally on the right of indemnification in favor of the

Difficult questions sometimes arise where the insurer, in seeking to enforce its right of indemnification as against the "risk," is met with the defence that the notes of the "risk" sued on, were given in consideration of an agreement by the insurer not to criminally prosecute the "risk," and are therefore void as against public policy and unenforceable. This matter was fully considered by the Supreme Court of Alabama in United States Fidelity and Guaranty Company *v.* Charles, *et al.*[1] In an action on such notes as are above referred to, an instruction was asked for to the effect that the "risk" must show by clear proof that in consideration therefor plaintiff agreed to refrain from criminal proceedings. This was held to have been properly refused, as misleading, being calculated to impress upon the jury that more than a reasonable preponderance of evidence is necessary. An instruction "that if the agreement between the plaintiffs and defendants, which included the signing of the notes sued on, is equally capable of two constructions, one legal and the other criminal, the jury should rather hold to the construction making the agreement legal," was held to have been properly refused as misleading and because excluding from the jury all evidence in the case except the agreement itself. The court in its opinion spoke as follows:

"That there was an implied contract under the law on the part of Caldwell to pay to the 'Guaranty Company' the amount so paid to the building and loan association for his said default, there can be no doubt, and that upon such implied contract a right of action exists and a recovery could be had by the guaranty company against the said Caldwell is equally clear; but that is not the contract here sued on. The contract here sued on is an express contract made by the said Caldwell, together with the defendants as his sureties, which is

insured against the "risk" the following cases: City Tr. Safe Dep. & Sur. Co. *v.* Am. Brewing Co., 174 N. Y. 487; 67 N. E. 62; Am. Nat. Bank *v.* Fid. & Dep. Co., 129 Ga. 126; S. E. ; Fid. & Dep. Co. *v.* Johnston, 117 La. 880; Sou. ; F. & C. Co. *v.* Jordan, 134 N. C. 236; S. E. ; U. S. Fid. & Guar. Co. *v.* Charles, *et al.*, 131 Ala. 658; 31 Sou. 558: Fid. & Dep. Co. of Md. *v.* Fid. Tr. Co., *et al.*, 143 Fed. 152.

[1] 131 Ala. 658; 31 Sou. 558.

based upon a consideration which is, at least in part, illegal. It is contended by counsel for appellant that the only difference between the contract sued upon is one of evidence. In this contention appellant's counsel is mistaken. The express contract, besides carrying with it the obligation of the defendants as sureties, also provides for a waiver of exemptions, neither of which existed in the implied contract. The plaintiff in his action relied wholly upon the express contract upon which he must stand or fall, without any regard to the implied contract, which the law raised up between the plaintiff and the principal debtor out of the circumstances of the default and embezzlement. It is a well-settled principle of law that a consideration in part illegal will vacate the entire contract.

"The fact that there was a contractual relation existing between Caldwell and the guaranty company by virtue of the latter's suretyship upon a bond for the faithful performance of duty by Caldwell to his employer, the Standard Building and Loan Association, cannot vary the principle laid down in the authorities above cited, or purge the contract of the illegality of consideration. When the guaranty company paid the amount of the default to the loan company, it then occupied the same relation to the embezzler, as to the implied promise made by him to refund, as existed between the embezzler and the loan company from whom he embezzled the funds before said guaranty company settled the defalcation. It is the promise as an inducement to the contract sued upon, that the payee will abstain from criminal prosecution of the principal maker, that taints the consideration of the note, being opposed to public policy and offensive to the law." [1]

§ 291. **The Right of Indemnification — How affected by Stipulations in the Contract of Indemnity.** — Frequent and ingenious are the clauses inserted by insurers in both policies and contracts of indemnity whereby it has been sought to render easy and sure the road towards prompt indemnity from the "risk" for losses paid by the insurer to the insured under the policy. Before stating in terms what these are, it may be remarked that it does at times seem like a hardship on the insurer to compel him, after a stubborn contest with the insured over the payment of a loss, to establish at great

[1] See also Fid. & Dep. Co. *v.* Fid. & Tr. Co., *et al.*, 143 Fed. 152; Baum *v.* Nat. Sur. & Guar. Co., 19 Pa. Sup. Ct. 23; East Stroudburg Nat. Bank *v.* Seeple, 3 Pa. Dist. Ct. 575.

expense the "risk's" liability to itself, after payment of the claim. Occasionally the courts have judicially recognized this fact. The case of King *v.* Victoria Insurance Company [1] affords an excellent example of this kind. The facts in that case were as follows: Plaintiff had insured a cargo of wool in transit to Australia. It was injured through negligence on the part of officers of the Queensland government. The insurance company paid the loss, and took an assignment of the claim for damages from the insured against the Queensland government. Defendants relied mainly on the defence that the loss paid was not covered by the policy, and was paid without any legal liability so to pay. The court, in its opinion in the case, spoke as follows:

"To us it seems a very startling proposition to say that when the insurers and insured have settled a claim of loss between themselves, a third party who caused the loss may insist upon ripping up the settlement and on putting in a plea for the insurer which they did not think it right to put in for themselves, and all for the purpose of availing himself of a highly technical rule of law, which has no bearing on his own wrongful act. It is not alleged that there is anything but perfect good faith in the claim made by the insured and satisfied by the insurance company. It is not alleged that the question of negligence has not been fully and fairly tried in that action as it could have been in an action by the government. But it was argued, as a matter of positive law, that in order to sue for damage done to injured goods, insurers must show that if they had disputed their liability, the claim of the insured must have been made good against them. If that be good law, the consequences would be that insurers could never admit a claim, on which dispute might be raised, except at the risk of finding themselves involved in the very dispute that they had tried to avoid with persons who had no interest in that dispute, but were sued as being the authors of that loss. The proposition is as novel as it is startling. As with regard to the question whether the loss is or is not within the terms of the policy, whatever might have been the result of a dispute between the parties to it, there is nothing to suggest that the claim is not one which the insured might not honestly and reasonably make, or one to which the insurer might not honestly and reasonably accede. We will assume, as the court below has

[1] 74 Law Times, 206.

assumed, that the insured could not, by the terms of the policy, have compelled the insurer to indemnify them. Still if, on a claim being made, the insurers treat it as within the contract, by what right can a stranger say that it was not so? The payment would not be made if no policy existed, and it seems to us an extravagant theory to say that a payment made in such circumstances is a voluntary payment on the policy carrying with it the legal incidents of such payments. Such settlement of claim between the parties ought not to be opened for a by-purpose at the instance of parties not concerned. To hold otherwise would convert rules of law framed for the purpose of checking speculations in lawsuits into instruments for promoting lawsuits, which the parties interested were wise enough to avoid by agreement." [1]

Returning now to the subject of the language employed in express contracts of indemnity to secure to the fullest extent the rights sought therein to be preserved, the following may be given as a common example of those contract provisions above referred to, to wit:

"That he (the 'risk'), for himself, his heirs, and administrators, hereby agrees to indemnify the insurer against any loss or damage it may sustain or become liable for in consequence of this policy or any renewal thereof, and forthwith after the insurer shall have paid the insured or any person or persons entitled to the same any money under or by reason of such bond, to reimburse the insurer for all amounts so paid, and all other losses, damages, costs, charges and expenses, if any, that the insurer shall in any way incur or become liable for in consequence of such policy, and also that any proper evidence of payment by the said insurer of any such loss, damage or expense shall be *conclusive evidence* against him and his estate, of the fact and extent of his liability to said insurer under this agreement."

The question now comes up as to what is the legal force and effect of such provisions as the above, making certain evidence conclusive upon the "risk." Such clauses as the foregoing have been upheld by the courts of England, where the matter has often been presented. The leading case there is London Tramways Company *v.* Bailey.[2] In this case Bailey had been a conductor of the tramway company under an agreement by which he was to pay them £25, to be retained,

[1] See also Guar. Co. of N. A. *v.* Pitts, 30 Sou. 758.

[2] L. R. 3 Queen's Bench Div. 217.

together with his wages for the current week, as security for the proper discharge of his duties. It was further stipulated, in case of any breach by him, that the company might retain this £25 and his wages for the current week as damages for such breach, and it was provided that the manager of the company should be the sole judge between the company and the conductor as to whether there had been a breach, and that his certificate should be binding and conclusive evidence of the fact in all courts of justice.

It was held that the agreement was not illegal and that the proceeding being a civil one, the manager's certificate that the deposit and wages had been forfeited was conclusive of the fact, precluding the magistrate from making any further inquiry.[1]

The above decisions have seldom been followed in the United States, where all such provisions, in so far as they attempt to make such proof *conclusive* upon the risk, are declared to be against public policy and *to that extent* void. A leading case on this subject is that of the Fidelity and Casualty Company of New York *v.* Eickhoff,[2] where the court spoke as follows:

"The right of a party to waive the protection of the law is subject to the control of public policy, which cannot be set aside or contravened by any arrangement or agreement of the parties, however expressed. Thus an agreement to waive the defence of usury is void. So, also, according to the weight of authority, is an agreement made at the time of contracting a debt to waive the prospective right of exemption. The agreement under consideration is more than a mere enlargement of contractual rights or the establishment of a rule of evidence. It provides that the plaintiff may by his own *ex parte* acts conclusively determine and establish the existence of his own cause of action. In short, he is made the supreme judge of his own case. The case is not at all analogous to the common provisions in building and construc-

[1] See also Wilson *v.* Glasgow Tramways & Omnibus Co., 5 Scotch Sess. Cas. (4th Ser.) 981, and Glasgow Tramway & Omnibus Co. *v.* Dempsey, 3 Cowp. Just. 440; Scott *v.* Avery, 5 H. L. Cas. 811; Brown *v.* Overbury, 11 Ex. Rep. 715.

[2] 63 Minn. 170; 65 N. W. 351.

tion contracts by which the determination of some third person, such as the architect or engineer, as to the amount or character of the work is made conclusive between the parties, in the absence of fraud or mistake. Nor is it at all analogous to a provision in an executory contract for the sale or manufacture of an article to the satisfaction of the buyer where, if the article is declined, the parties are, in contemplation of law, left *in statu quo*. In the present case the attempt is to provide that after the alleged cause has occurred, the plaintiff shall be the sole and conclusive judge of both its existence and extent. Such an agreement is clearly against public policy. Had the provision been that the voucher or other evidence of payment should be merely *prima facie* evidence of the fact and extent of defendant's liability, — thus merely shifting the burden of proof, but leaving the defendant at liberty to rebut this *prima facie* evidence, — although even then a somewhat drastic provision, we do not think it could be held to contravene public policy. To that extent we think the provision is valid, but in so far as it assumes to make the voucher of payment by plaintiff conclusive of defendant's liability, it is void."

In a later case this same court went into the subject again briefly, as follows:

"In this case, as in the Eickhoff case, the guaranteed agent in his application for the guaranty bond stipulated that the voucher or other evidence of payment by the plaintiff to the elevator company should be conclusive evidence against him of the fact and extent of his liability to the plaintiff. In the Eickhoff case we held that this stipulation was void as being against public policy in so far as it made such voucher or other evidence of payment conclusive. Counsel suggests that this was *obiter*, the case having been considered simply with reference to the future trial, but we see no good reason for changing our views, and therefore adhere to what was said in that case. And assuming that the voucher or evidence of payment introduced in this case was *prima facie* evidence of the fact and extent of defendant's liability to plaintiff, shifting the burden of proof upon defendant, we are of the opinion that the trial court was justified in concluding that this *prima facie* case was sufficiently rebutted." [1]

In White *v.* Middlesex Railroad Company [2] it was held that an agreement between a railroad company and a conductor

[1] F. & C. Co. *v.* Crays, 76 Minn. 450; 79 N. W. Rep. 521; see also F. & C. *v.* Lawler, *et al.*, 64 Minn. 144; 66 N. W. Rep. 143; Eickhoff *v.* F. & C. Co., 74 Minn. 139; 76 N. W. Rep. 1030.

[2] 135 Mass. 216.

to the effect that the railroad company's president should be the sole judge between the company and the conductor as to whether the company is entitled to retain and hold a certain sum deposited by the conductor as security for the proper discharge of his duties, and for the accounting and paying over to the railroad company of all fares received, together with the provision that the president's certificate stating that said sum was to be retained as forfeited to the company, and as to the cause of such retention, should be a final adjudication thereof, and binding and conclusive evidence between the parties in all courts of justice, was void as against public policy.[1]

In a very recent case[2] the Supreme Court of Mississippi had occasion to construe a clause in a contract of indemnity given by the "risk" to the insurer, which provided that the voucher, showing payment of loss by the insurer to the insured, should be conclusive upon the "risk" as to the fact and extent of his liability to such insurer. In passing upon the question the court spoke as follows:

"One of the conditions upon which the company became guarantor for Pitts is that the voucher or receipt to it for money paid in good faith for him to the obligee of the bond should be conclusive of the fact of his liability to the obligee for the sum paid; in other words, if the guarantee company should in good faith discharge a claim by the obligee for a liability asserted against Pitts, the voucher or receipt for the payment should be proof of the liability of Pitts. There is nothing wrong or unreasonable or against public policy in this stipulation. Parties, *sui juris*, may lawfully make such stipulations and are bound by them. Under such contract the insurer was authorized to advance, as a condition of guaranteeing, to exercise discretion as to paying any demand made by the holder of the guarantee, and was bound only to act without fraud in settling a claim, and thus paying is entitled to hold the party guaranteed for reimbursements, and the voucher proves the claim, if not shown, to have been infected with fraud. The expense, delay, trouble and risk of loss to the insurer is a sufficient safeguard against any unwarranted payment; and with-

[1] See, *contra*, Guar. Co. of N. A. *v.* Pitts, 30 Sou. 758.

[2] Guar. Co. of N. A. *v.* Pitts, 30 Sou. 758.

out such a stipulation as complained of here, guarantee companies could not safely do business anything like as cheaply as they do, and to the evident advantage of the parties and of the general public. The stipulations of the bond are not influential in this case, which is determinable, by the stipulations inducing the company to execute the bond. This suit is not on the bond."

Our conclusions on this subject may be stated as follows: Such stipulations as the one under consideration should be held to be conclusive upon the "risk" in an action brought against him by the insurer to recover indemnity, for any moneys paid by it to the insured in settlement of a loss coming within the term of a policy of guaranty insurance, in the absence of fraud or collusion between the insurer and the insured. It is unconscionable, in our opinion, that the insurer, after settling in good faith a loss under the policy with the insured, should be compelled to bear the burden of protracted litigation with the "risk," in order to recover reimbursement for moneys so expended for the use and benefit of such "risk."

A somewhat different question is presented in the case of Fidelity and Casualty Company *v.* Harder, *et al.*[1] Here a surety company which was on the bond of a treasurer of a corporation, on his subsequently being charged with embezzlement, received from him a bond authorizing the company to enter judgment, after it had satisfied itself as to its liability, and the judgment was subsequently entered on the indemnity bond. It was held that, on a ruling to open such a judgment, parol evidence on the part of the defendant (the "risk") was admissible to show a parol contract made prior to the execution of the bond, that it should not be proceeded upon, until the liability of the treasurer to his company had been established at law. The court in its opinion spoke as follows:

"The appellant complains because it is contended that under the express provisions of the bond the right to have the liability of Harder determined by jury had been waived, and that, having satisfied itself of the defalcation, misappropriation and embezzlement of funds, the rights of appellees were concluded thereby. The appellant undertakes

[1] 212 Pa. 96; 61 Atl. 880.

to sustain this contention by that provision of the bond of indemnity which avers 'And further, if the amount under this bond is not paid upon demand of said Fidelity and Casualty Company, its certain attorneys, successors or assigns, and after said company has satisfied itself as to its liability under such bond, then we do hereby authorize and empower any attorney of any court of record in the state of Pennsylvania or elsewhere to appear for us and confess judgment against us for the penal sum with costs of suit, etc.'

"It is argued under this provision of the bond the appellant had the right to make its investigation *ex parte* without due course of law, and entirely independent of the rights or suggestions of the appellees. It is further contended by the learned counsel for appellant that the appellees have no rights to be considered by the court, and no questions of fact to be determined by the jury. We are not convinced of the soundness of this position. It is certainly unsound, if the parol contract set up by the appellees be sustained. Parol evidence is admissible to alter, vary or contradict a written statement, where such evidence establishes an oral agreement contemporaneous with the execution of the writing on the faith of which the instrument was executed. . . .

"We do not agree with the learned counsel for the appellant in the construction placed upon the bond itself. The provision, 'after such company has satisfied itself as to the liability under such bond,' it shall have the right to enter judgment, is not a condition of the bond bearing upon the liability of the parties. This provision occurs in a subsequent paragraph to that in which the conditions of the bond are set out. The evident purpose thereof was to give appellant the right to enter judgment as soon as it satisfied itself of its liability under the original bond by making an examination of the accounts. In other words, it was a condition precedent to the entry of the judgment, and not a condition affecting the purpose of the bond itself. This was in the interest of the appellant so that it could enter judgment and preserve its lien against the property of the appellees; but it certainly was not intended that they should be concluded by the entry of the judgment and not be permitted to have the same opened so that they could be let into a defence in the event that they had a just defence to the cause of action. This view of the case is in corroboration of the contention of the appellees; that is to say, execution was not to be issued on judgment until the liability of Harder as principal, and the appellant as surety, had been established by due process of law on the original bond. In other words,

the appellant held the bond containing a power of attorney to confess judgment, but was not to enter judgment until it had satisfied itself of the liability on the original bond, and then was not to proceed to collect the same until the liability of Harder had been established by due process of law."

§ 292. **The Necessary Requisites to establish a Complete Right of Indemnification in Favor of the Insurer as against the "Risk."** — These may be briefly stated as follows:

1. A request, either express or implied, from the "risk" to the insurer, that a policy be issued in his behalf to the insured.

2. The execution of, delivery to, and acceptance by the insured of the policy requested by the "risk."

3. Notice and proof of loss by the insured to the insurer.

4. Allowance and payment of claim duly presented after investigation thereof, by the insurer to the insured.

5. Evidence that the claim so paid was a legal and enforceable one under the policy.

6. A promise, either express or implied, on the part of the "risk," to indemnify the insurer.

The foregoing matters will now be considered and taken up for separate consideration.

§ 293. **A Request for the Policy by the "Risk" — How shown.** — The general principle that no one can make himself a creditor of another without his consent or against his will has an undoubted application to guaranty insurance. It therefore follows that to give the insurer any rights, other than those arising by way of subrogation, as against the "risk" after payment of loss, it must appear that the policy was issued in the first instance at the request of the "risk."

Such request may be either express or implied.[1] But unless there has been such a request, the insurer cannot recover from the "risk" after the payment of loss, save as such right is given under the doctrine of subrogation heretofore

[1] Am. Bond. Co. *v.* Dufur, *et al.*, Wash. ; 96 Pac. 160.

referred to.[1] A mere stranger or volunteer who pays the debt cannot thus be subrogated to the insured's rights.[2]

§ 294. **The Execution, Delivery to, and Acceptance by the Insured of the Policy requested by the "Risk."** — After having been requested by the "risk" to furnish the policy, it of course follows that this request must be complied with in terms of the request. That is, the policy so furnished must be of the kind, nature and content called for by such request. For where the policy does not conform in terms to the application, there is no corresponding obligation on the part of the "risk," under his contract of indemnity, to reimburse the insurer for claims paid thereunder to the insured. But difficulties often arise through professed ignorance on the part of the "risk" as to the provisions of the policy furnished, claiming, after a loss has been incurred, that the policy was not of the kind and nature requested by him. Of course where the "risk" — as is sometimes the case — signs the policy with the insurer, no question of this nature can possibly arise. But where reference must be had solely to the "application," to determine the nature of the policy sought for by the "risk," a more difficult question is presented.

With respect to guaranty insurance contracts it may be stated generally, that in the absence of fraud on the part of the insurer or its agent, and in the absence of illiteracy or bodily infirmity on the part of the "risk" such as to render him incapable of contracting, the latter is bound to know the contents of his application. The same rule applies here as is held applicable to "proposals" for a policy on the part of employers.[3] The rule here referred to is well stated in Ryan *v.* World Life Insurance Company[4] as follows:

[1] See *ante*, §§ 290–291.

[2] Queen *v.* O'Bryan, 37 Canada L. J. 303; see also U. S. Fid. & Guar. Co. *v.* Siegman, 87 Minn. 175; 91 N. W. 473; Herpolsheiner *v.* Hansell-Elcock Co., 141 Mich. 367; 104 N. W. 671; Henningsen *v.* U. S. Fid. & Guar. Co., 208 U. S. 404.

[3] Ætna Indemn. Co. *v.* Ryan, 103 N. Y. Sup. 756; Equit. Life Ins. Soc. *v.* Mueller.

[4] 41 Conn. 172.

"If the insured signed the application without reading it, and without its being read, that in itself was inexcusable negligence. The application containing her agreement and representation is an important contract. When she signed it she was bound to know what she signed. The law requires that the insured shall not only in good faith answer all the interrogatories correctly, but shall use reasonable diligence to see that the answers are correctly written. It is for his interest to do so, and the insurer has a right to presume that he will do it. He has it in his power to prevent this species of fraud, and the insurer has not."

Again the United States Supreme Court,[1] through Justice Field, has laid down a similar rule as follows:

"It was the insured's duty to read the application he signed. He knew that upon it the policy would be issued, if at all. It would introduce great uncertainty in all business transactions if the party making the written proposals for a contract with representations to induce its execution, should be allowed to show, after it had been obtained, that he did not know the contents of his proposals and to enforce it, notwithstanding their falsity as to matters essential to its obligations and validity. Contracts could not be made or business fairly conducted if such a rule should prevail, and there is no reason why it should be applied merely to contracts of insurance. There is nothing in their nature which distinguishes them in particular from others. But here the right is asserted to prove, not only that the assured did not make the statements contained in his answers, but that he never read the application, and to recover upon a contract obtained by representations admitted to be false, just as though they were true. If he had read even the printed lines of the application, he would have seen that it stipulated that the rights of the company should in no respect be affected by his verbal statements or by those of his agents, unless the same was in writing and forwarded with his application to the home office. The company, like any other principal, could limit the authority of its agents and thus bind all parties dealing with them with knowledge of the limitation. It must be presumed that he read the application, and was cognizant of the limitations therein expressed."

In the absence of fraud, a person who is competent to contract is conclusively presumed to have made the contract

[1] N. Y. Life Ins. Co. *v.* Fletcher, 117 U. S. 529.

which he signs and to be bound by its terms, though he is in fact ignorant of its contents.[1]

The "risk," under such circumstances as we are now considering, must be presumed to know the contents of the application he signs. If the language thereof was ambiguous or prejudicial to his rights, he should have refused to sign it or have applied to the insurer to have its language or terms amended.[2]

The rule in this connection may be stated as follows: That persons having capacity to make a contract must, in the absence of fraud, misrepresentation, or concealment, be held to have known what the words used in a contract made by them were, and to have known their meaning; and they must also be held to have known and fully comprehended the legal effect of the contract which the words used made. Contracts for insurance do not furnish an exception to this rule. But there is a most important element of estoppel present in all such cases, arising from the fact that the "risk," having accepted the benefits to be derived from the issuing of a policy in his behalf, cannot escape the burdens connected therewith. Where a party by mistake chooses to sign a contract which gives full effect to the parties' intentions and one of them acts on it, the other cannot say, after liability has occurred, "I meant what I have not stated; and though you have relied upon my statement, I will only be liable for what I meant." Finally, in this connection it seems entirely safe to assert, that no matter what the rights of the "risk" may have been in the beginning and prior to his securing employment through the issuing of a policy by the insurer to the insured in his behalf, after this has been done and he has secured employment on the strength of it, he then becomes estopped, with respect to his obligations to the insurer, from claiming that the policy furnished by the latter was not of the kind and nature requested by him in his application for

[1] See De Jernette *v.* F. & C. Co. of N. Y., 98 Ky. 558; 33 S. W. 828.

[2] See Lyman *v.* Bruker *et al.*, 26 N. Y. Misc. Rep. 594.

the same. On the question as to what constitutes legal proof of the execution of the policy by the insurer the case of Fidelity and Casualty Company of New York *v.* Yoder is in point.[1] Here the insurer sued the "risk" to compel the latter to indemnify it on account of a loss paid under a blanket policy to the Missouri Pacific Railway Company. The petition set out the policy issued by the insurer to the insured, insuring the honesty of certain employees of the latter, including the particular "risk" sued in that action. The execution of the policy was denied by verified answer in positive terms. No proof of its execution was made. The written application for the policy itself was made by the railway company, and the proof showed that the "risk" never saw it. An officer of the railway company testified that the original policy was in his possession and that he had attached a copy thereof to his deposition. This was held insufficient to prove the execution of the instrument.

It often becomes an important question to determine the kind of indemnity policy applied for by the "risk" as set forth in his written application. This question may be answered, not only by a reference to the wording of the application itself, but also by reference to the proposal of the insured, if any there be, and also by taking cognizance of the situation of all the parties, insured, insurer and the "risk," at the time that the application for the guaranty policy was made. First of all the situation of the parties should be looked at as it existed at the time the application for the policy was sent in. With regard to the "risk," it should be observed that he is seeking to secure some position of trust, the door to which is only open to him through the medium of a guaranty insurance bond. On the part of the insured there exists the necessity of filling such a position of trust in a manner conducive to the safety of the handling of funds in connection with the duties of such trust position, and a further necessity of obtaining some assurance that the duties of the same will be faith-

[1] 64 Pac. Rep. 1027.

fully performed. This again is sought for on the part of the insured through the medium of a guaranty insurance bond. Finally, on the part of the insurer is the desire to secure a premium, through assuming a liability which shall be proportionate to the amount of the premium received therefor. From the foregoing it is clear that in order to secure a position of trust, the "risk" must first furnish a satisfactory indemnity policy to the insured. The word "satisfactory" is used as addressing itself, not to the mind of the "risk," but rather to that of the insured. It is the latter rather than the former whose approval of the policy offered is to be sought and secured. By what has just been said it is not to be inferred that the "risk" has no rights whatever in the premises. That is very far from true. The legal rules governing this question may be stated as follows:

1. If the application itself contains words indicative of the fact that the "risk" is cognizant of the nature and content of the policy proposed to be granted by the insurer to the insured, in such case the "risk" is estopped to deny that the policy furnished by the insurer to the insured was not of the kind and nature requested by him. Thus, for example, the "risk" not infrequently agrees in terms to reimburse the insurer for any loss or damage or expense that it may sustain or become liable for in consequence of guaranteeing the insured against loss through his acts, defaults, and neglects, "*as provided in such guarantee.*" It is upon the words "as provided in such guarantee," that the insurer must base the principle of estoppel to the effect that the "risk" is precluded by his own words from attempting to show that the policy furnished by the insurer to the insured was not of the kind requested by him in his application.[1]

[1] See Am. Bond. Co. *v.* Loeb, Wash. ; 92 Pac. 282; Ætna Indemn. Co. *v.* Ryan, 103 N. Y. Sup. 756; Am. Bond. & Tr. Co. *v.* New Amsterdam Cas. Co., 125 Ill. App. 33.

2. In view of the fact that it is the insured rather than the "risk" who is the party whose requirements with reference to the nature and content of the policy applied for are to be consulted by the insurer, the acceptance of the policy by the insured concludes the "risk" from afterwards asserting that such policy was not of the kind and nature requested by him, especially when it appears that he has accepted its benefits.[1]

The obtaining of the position of trust by the "risk" with the insured on the strength of the procurement of the policy of guaranty insurance from the insurer and its subsequent acceptance by the insured, estops the "risk" from afterwards claiming that the policy so furnished was not of the kind and nature requested by him.

§ 295. **Necessity of showing Notice and Proof of Loss by Insured to the Insurer.** — The theory on which the insurer seeks to recover from the "risk" is that it has been compelled to pay the insured a certain sum of money, in response to a legal obligation evidenced by the policy issued by the insurer to the insured at the request of the "risk." Now it is unquestionably true that any and all conditions of a policy (and this includes, of course, the usual ones with respect to notice and proof of loss) may be waived by the insurer if it sees fit so to do, they being inserted therein for the latter's benefit. But a somewhat different question is presented when the insurer seeks to recover from the "risk" moneys paid by it on account of losses incurred by the insured, which, though covered by the policy, have never been made the basis of a formal claim supported by the customary proof. It has been claimed that such a case would come under the application of the principle, that the law does not allow a person to make another his debtor by volunteering to pay his debt, and that therefore the insurer should be held to strict proof as to sub-

[1] See Am. Bond. Co. *v.* Loeb, Wash. ; 92 Pac. 282; Ætna Indemn. Co. *v.* Ryan, 103 N. Y. Sup. 756; Am. Bond. & Tr. Co. *v.* New Amsterdam Cas. Co., 125 Ill. App. 33.

stantial compliance by the insured with all provisions of the policy as to notice and proof of loss, in order to enable it to exact indemnity from the "risk." This proposition, it would seem, is not without some authority to support it. It was said by the court in Fidelity and Casualty Company *v.* Eickhoff [1] that where a policy is executed at the request of the "risk," it follows that his obligation to indemnify the insurer is coextensive with that of such insurer to reimburse the insured. Now this being true, the question presents itself whether, under such circumstances, there exists any legal liability on the part of the insurer to the insured to settle losses whereof no notice or proof of claim was filed. The answer is, no. Does it not therefore follow that the "risk's" obligations being coextensive with that of the insurer's, its duty to indemnify the insurer after payment of loss cannot be said to exist where there is no notice or proof of such loss filed by the insured with the insurer? There is no well-defined principle of agency, either express or implied, which authorizes the insurer in behalf of the "risk" to waive these matters and thereby affect the rights of the latter in that connection. There is, however, still another and different view which might be taken of this question. It is this: Assuming that the insurer was liable under the terms of the policy for a loss, would not the bare existence of such legal liability be a sufficient justification in the eyes of the law for a payment of such loss to the insured, notwithstanding that the latter had filed no written notice or proof of loss, as provided for in the policy? In other words, it would seem reasonable to assert that the mere act of the insurer in waiving formal proofs of loss should not so operate as to deprive it of the right to demand indemnity from the "risk" on account of a loss paid under such circumstances. The true view of the matter would seem to be this: The insurer cannot of its own initiative (if such a course of proceeding can be conceived of) volunteer to pay a claim not previously presented by the insured, and

[1] 63 Minn. 170; 65 N. W. 351.

then call upon the "risk" to indemnify it on account of such payment. But when the insured has himself taken the initiative and in some manner — no matter how informally — preferred a claim under the policy against the insurer, then it would seem that the latter should have the right to waive formal provisions of the policy with respect to notice and proof of loss, and still have the right to claim indemnity from the "risk."[1]

§ 296. **Allowance and Payment of Claims after Investigation thereof by the Insurer.** — No action at law can be maintained by the insurer against the "risk" to compel the indemnity before the former has paid the loss for which a claim has been filed by the insured.[2]

In this connection it would seem proper, as a matter of evidence, that the insurer should offer testimony tending to prove that it made a thorough and careful investigation of the claim; this on the ground that such evidence tends to establish the insurer's good faith in paying the claim in all cases where the existence of a legal liability on the part of the insurer to pay such claim or the existence of collusion between the insurer and the insured are matters at issue before a court or jury. This would undoubtedly be admissible where fraud or collusion with the insured in the payment of a claim was charged by the "risk" against the insurer.[3]

§ 297. **The Claim paid by the Insurer to the Insured must have been a Valid and Enforceable one under the Policy.** —The broad general proposition may be laid down that where the insurer is under no legal liability to pay a claim to the insured under the policy, it cannot recover therefor from the "risk," by way of enforcement of any express or implied agreement to indemnify.[4]

[1] See Herpolsheimer *v.* Hansell-Elcock Co., 141 Mich. 367; 104 N. W. 671.

[2] See American Bond. & Tr. Co. *v.* L. & W. Va. Gas Co., 95 Fed. 49.

[3] See State *ex rel.* *v.* Sur. Co., 76 Mo. App. 227.

[4] Wilkes *v.* Harper, 1 N. Y. 586; Merc. Mut. Ins. Co. *v.* Calebs, *et al.*, 20 N. Y. 173; City Tr. Safe Dep.

It has even been said [1] "that a surety cannot accelerate the liability of the principal by paying the liability before it is due." But the principle certainly could not be so extended as to forbid an insurer paying a claim before the expiration of the time customarily allowed in all policies for paying claims.[2]

In this immediate connection a most important and practical question presents itself as to what evidence it is necessary for the insurer to introduce in order to establish its right to demand indemnity from the "risk" on account of losses incurred by it under the policy through acts of such "risk."

The subject here referred to was considered at some length in the case of the Fidelity and Casualty Company of New York *v.* Eickhoff.[3] This was an action brought by the insurer to compel one Eickhoff (the "risk") to make good and reimburse to it certain moneys which it had been compelled to pay to the insured, by reason of certain alleged acts of fraud or dishonesty on the part of said Eickhoff. In its opinion in this case the Supreme Court of Minnesota (Mitchell, Judge) spoke as follows:

"Our construction is that the plaintiff was only bound to make good and reimburse the elevator company for loss sustained by reason of a shortage of grain caused by the actual fraud or dishonesty of the defendant. But the bond also provides how the existence and amount of a shortage shall be ascertained; it shall be accepted as evidence that it was caused by the fraud or dishonesty of the defendant and not by any of the various other causes, enumerated as exceptions, for which the plaintiff was not to be liable; in other words, that a shortage ascertained in the manner prescribed should be *prima facie* evidence of its existence and that it was caused by defendant's fraud or dishonesty, thus casting the burden upon the plaintiff to rebut

& Sur. Co. *v.* Haaslocherf, 101 N. Y. App. Div. 415; 91 N. Y. Sup. 1022; Blades *v.* Dewey, 136 N. C. 176; 48 S. E. 626; Champion Ice & Cold Storage Co. *v.* Am. Bond. & Tr. Co., Ky. Ct. of App. ; 75 S. W. 197; Herpolsheimer *v.* Hansell-Elcock Co., 141 Mich. 367; 104 N. W. 671.

[1] Addison on Contracts, p. 1013.

[2] See City Tr. & Sur. Co. *v.* F. & C. Co. of N. Y., 58 N. Y. App. Div. 18.

[3] 63 Minn. 170; 65 N. W. 351.

this *prima facie* case of proof. It is not bound to do this by affirmative evidence showing the particular one of the causes enumerated as exceptions which produced the shortage, but may do it by negative evidence showing that it was not caused by the fraud or dishonesty of the defendant, and hence must have been produced by one or more of the excepted causes. This it may do by a fair preponderance of evidence as to any of the excepted causes, except errors and carelessness in weighing and thefts by persons other than those covered by the bond, in which cases the proof must be conclusive. The word 'conclusive' in this connection must be construed as meaning so strong as to require a finding or verdict that the shortage resulted from the cause alleged. This may also be done by negative or circumstantial evidence."

Another instructive case along this same line is that of the Fidelity and Casualty Company of New York *v.* Crays.[1]

Here the Fidelity and Casualty Company of New York issued a policy on one Crays as the "risk" in charge of a grain elevator in the employ of the Peavey Elevator Company, the insured. The policy under which Crays had been bonded provided that the Fidelity and Casualty Company should only be liable for acts of fraud and dishonesty on the part of Crays personally, and not for his errors, mistakes or mere negligence. A claim was put in by the Peavey Elevator Company for loss claimed to have arisen by reason of Crays' failure and refusal to deliver or turn over to the Peavey Elevator Company all the grain which he had bought and received for it. This claim was paid by the Fidelity and Casualty Company to the elevator company, and an action was thereafter brought by the Fidelity and Casualty Company against Crays to compel him to reimburse it for the amount so paid to the elevator company. This action was brought on Crays' written agreement to reimburse the Fidelity and Casualty Company for any moneys that it should pay on his account by reason of the issuance of the policy above referred to. The court, in refusing to allow the insurer to recover thereon, said:

[1] 76 Minn. 450; 79 N. W. 531.

"We shall assume, without deciding, that the evidence was conclusive that the bond of indemnity declared on was in the form and of the kind requested by the defendant, and direct our attention to the evidence of the shortage for which plaintiff (the Fidelity and Casualty Company) was liable to the elevator company. It will be seen from an examination of the bond that the plaintiff was only liable for acts of fraud and dishonesty on the part of the defendant personally, and not for his errors, mistakes, or mere negligence. The mode of ascertaining a shortage in the grain accounts of receiving agents at elevators was as follows: There shall be deducted from the total amount of grain and dockage received by the receiving agents at said grain elevators the amount of grain on hand, screenings and dirt from such grain as has been cleaned at such elevator or elevators, together with the amount of shipments based upon weights of grain and dockage at terminals, and if the result shows a deficit and the shortage is not caused by the various exceptions agreed to, this proof of loss will be accepted as binding on the company. We shall also assume, without deciding, that this mode of ascertaining a shortage is binding on the agent guaranteed as well as upon the plaintiff, and that the shortage ascertained in the mode prescribed is evidence, not only of the fact of the amount of the shortage, but also that it was caused by the fraud and dishonesty of the agent, although to so hold would practically render the agents guarantors not only of the absolute accuracy of their own weights, but also of the weights at terminals, with which they have nothing to do and over which they have no control, and this, too, under the penalty of being branded with fraud and dishonesty if there is any discrepancy between the two weights. But if it is to be held that the agents have assumed any such drastic liabilities, certainly the plaintiff should be held very strictly to the mode of proof prescribed in the bond. The method of proving the defendant's shortage adopted on the trial and the way the elevator company's account with him was kept was to charge him with the amount of grain which he reported from day to day that he had taken into the elevator and to credit him with the alleged weights at terminals to which the wheat had been shipped by order of the elevator company. The defendant, as a witness in his own behalf, testified positively that he shipped out at the direction of the elevator company all the wheat that he took in or received for it and never sold or disposed of any of the grain in any other way and never had converted to his own use a particle of the wheat, and that he never admitted that there was a shortage. There was no evidence in the case tending in the least to impeach or cast suspicion on his honesty

or integrity, except the bare fact of his shortage of three hundred and thirty bushels out of all the wheat he handled from September to May. Upon this state of the evidence the trial court was amply justified in finding that there was no shortage proven, at least none for which the plaintiff was liable to the elevator company."

The construction of express contracts of indemnity running from the " risk " to the insurer is touched upon in American Surety Company *v.* Thurber, *et al.*,[1] where it was said that the extent of the " risk's " liability under such contracts depends upon the wording thereof, and the agreement is to be construed so as to give effect to each and every part thereof, according to the intentions of the parties at the time. Where there is no ambiguity, the operative words of the contract cannot be controlled by erroneous recitals.

The " risk," even when confined in the penitentiary, may be sued at law by the insurer on his agreement to indemnify the latter after payment of loss to the insured.[2]

After payment of loss by the insurer to the insured, if a demand is necessary in order to recover from the " risk " (and the necessity for such a demand is very doubtful), it is the former, and not the latter, who should make the demand upon the " risk " where suit is brought upon the contract of indemnity.[3]

It is unnecessary, in order to sustain the insurer's right to exact indemnity from the " risk," to show that payment to the insured was made with notice thereof, to such " risk." [4]

§ 298. **A Promise to indemnify by the " Risk " — How shown.** — This is ordinarily shown by the introduction of evidence of the written contract to indemnify. In the absence of such written agreement, the following appears to be the rule: Where the policy is issued upon the request of the "risk," the law implies that the latter requested the payment of

[1] 21 N. Y. St. Rep. 459.

[2] Guar. Co. of N. A. *v.* First Nat. Bank of Lynchburg, 95 Va. 480; 28 S. E. 909.

[3] See People *ex rel.* Sur. Co. *v.* Anthony, 7 N. Y. App. Div. 132; Malone *v.* F. & C. Co., 71 Mo. App. 1.

[4] City Tr. Co. *v.* F. & C. Co. of N. Y., 58 N. Y. App. Div. 18.

losses thereunder to be made, and also implies a promise on the part of the "risk" to indemnify the insurer to the extent of all payments so made. It is immaterial whether this payment was made, in fact, at the request of the "risk," so long as the insurer was under a legal liability to the insured to make the same.[1]

The right of action on the part of the insurer against the "risk" for indemnification after payment of loss does not depend upon the fact that demand for reimbursement was made and refused before the action was commenced. At most, the absence of a demand might prevent the recovery of interest on claims paid.[2]

However, if the contract between the "risk" and the insurer provides for indemnity by the former to the latter "upon demand" therefor, then, of course, such demand is a condition precedent to the maintenance of any action to enforce the right of indemnity.[3]

In this immediate connection, certain general rules may be given with a view to suggesting the more important, rather than with the purpose of stating all which might be given on the subject of proof of loss by the insurer as against the "risk."

1. The insurer is not required to prove his cause of action literally, but in the absence of any contract provisions (as here before referred to) shifting the burden of proof, all claims for indemnity on the part of the insurer against the "risk" must be proved with substantially as much particularity as if a prior settlement of these same claims had never taken place between the insurer and the insured.[4]

2. If evidence offered and admitted proves a cause of action in itself, and that is supported by allegations of the complaint broad enough to cover it, this is sufficient.

[1] See Am. Bond. & Tr. Co. *v.* L. & W. Va. Gas Co., 95 Fed. 49.

[2] See Epstein *v.* U. S. Fid. & Guar. Co., 29 N. Y. Misc. 295.

[3] See Sooysmith & Co. *v.* Am. Sur. Co., 28 N. Y. App. Div. 346.

[4] See F. & C. Co. of N. Y. *v.* Eickhoff, 63 Minn. 170; 65 N. W. 351; F. & C. Co. of N. Y. *v.* Crays, 76 Minn. 450; 79 N. W. 531; *contra*, Guar. Co. of N. A. *v.* Pitts, 30 Sou. 758.

3. It is sufficient if the substance of the issue be established.

4. As part of the *res gestæ*, all books of accounts, letters and memoranda kept by the " risk " and relating to the claims sued upon are admissible in evidence.[1]

5. All admissions of the " risk " made against interest relative to the matter in issue are admissible in evidence.

6. All statements of account which have been shown to the " risk " and which relate to the matter in issue, and which have been by him formally admitted to be correct, and in reliance upon which the claim has been paid by the insured, are admissible in evidence against the " risk."

A most important case in this connection is City Trust Safe Deposit and Surety Company *v.* American Brewing Company.[2] The holding in this case was as follows: A surety, who, without knowledge that his principal was an agent for a third party, who was the real owner of the business, executed the statutory bond required to obtain a liquor tax certificate, and is compelled to pay a judgment recovered against him for a breach of the condition of the bond in that gambling was permitted on the premises, may maintain an action against the undisclosed principal to recover the amount paid, since the latter, while benefiting by the suretyship, violated the conditions of the bond and the statute and the direct effect of his act was to cause the surety a substantial loss beyond that suffered by the public, for which the third party is liable.[3]

§ 299. **The Measure of the " Risk's " Liability to the Insurer after the Payment of a Liability under the Policy to the Insured.** — At common law a surety could call upon his principal for

[1] Supreme Council, etc. *v.* F. & C. Co. of N. Y., 63 Fed. 48; Hall *v.* U. S. Fid. & Guar. Co., 77 Minn. 24; 74 N. W. 590.

[2] 174 N. Y. 486; 67 N. E. 62.

[3] See in connection with the foregoing the following cases: U. S. Fid. & Guar. Co. *v.* Donnelly, 72 N. J. L. 295; 61 Atl. 445; U. S. Fid. & Guar. Co. *v.* Seigmann, 87 Minn. 175; 91 N. W. 473; Am. Bond. Co. *v.* Ensey, 105 Md. 211; 65 Atl. 921; U. S. Fid. & Guar. Co. *v.* Charles, *et al.*, 131 Ala. 658; 31 Sou. 558; Folmar *v.* Siler, 132 Ala. 297; 31 Sou. 79; City Tr. Safe Dep. & Sur. Co. *v.* Waldbrauer, 95 N. Y. Sup. 222; Reid *v.* Pauly, 121 Fed. 652.

reimbursement, not only for what he may have been obliged to pay in discharge of the obligation for which he was bound, but also for all reasonable costs and expenses incurred in consequence of such default. The foregoing — in the absence of express stipulation — is undoubtedly the rule in contracts of guaranty insurance. The only limitations in such a case would be that the insurer could recover only the amount actually paid under a legal obligation to the insured so to do, and that the expenses must have been reasonable and incurred in good faith. The insurer is also entitled to interest on the amount paid. Occasionally there is inserted in the indemnity agreements given by the "risk" to the insurer some such clause as this: "I hereby agree that forthwith, after the company (the insurer) shall have paid the party or parties entitled to the same, any money under or by reason of such guarantee, to repay said company the amount so paid, and all other costs, damages, and expenses, if any, that it shall have incurred or become liable for, in consequence of such guarantees." Such agreements as the foregoing are undoubtedly valid, and the rule of law in such cases is as above stated; that is, the measure of the "risk's" liability to the insurer, after payment of loss under a policy, is the amount so paid with interest thereon, at the legal rate, together with all reasonable and legitimate expenses incurred by the insurer in connection therewith. Occasionally, too, one finds in the "risk's" contract of indemnity an agreement to give the insured the right to take possession of any moneys or property which the latter may find belonging to the "risk," and for that purpose to enter into any house, break doors, etc. And in case the insurer should make any payment under any such policy or agreement, the latter shall apply such money, or sell or dispose of such property as it shall deem best for its reimbursement, including expenses of reimbursement and cost of keeping such property, etc. The foregoing provisions are in part, at least, of questionable validity, and amount at most to a sort of inchoate lien or pledge on the moneys and proper-

ties of the "risk" that may belong to him at the time a loss incurs. Such a provision as the foregoing, however, would probably afford a sufficient legal justification for basing thereon a demand by the insurer upon the insured, for any salary due from the latter to the "risk," in connection with the employment out of which the liability sought to be enforced arose.[1]

CHAPTER XXIV

PRACTICE

§ 300. **General Remarks.** — It is not our purpose in this chapter to discuss at length matters of practice likely to arise in the trial of cases arising under policies of guaranty insurance. An attempt will be made, however, to make a few suggestions of a practical nature along this line.[2]

[1] See generally in this connection: Mullin & Fid. & Dep. Co. *v.* U. S., 109 Fed. 817; U. S. *v.* M'Intyre & Fid. & Dep. Co., 111 Fed. 590; U. S. etc. *v.* Morgan & Am. Sur. Co., 111 Fed. 474; Wood *v.* Brown, 104 Fed. 203; 43 C. C. A. 474; U. S. *v.* Am. Sur. Co., *et al.*, 110 Fed. 913; U. S. Fid. & Guar. Co. *v.* Hittle, 121 Ia. 352; 96 N. W. 782; Fid. & Dep. Co. *v.* Kepley, 66 Kan. 343; 71 Pac. 818; U. S. Fid. & Guar. Co. *v.* Donnelly, 72 N. J. L. 295; 61 Atl. 445; Am. Sur. Co. *v.* Ashmore, *et al.*, Kan. ; 86 Pac. 453; Am. Bond. Co. *v.* Dufur, *et al.*, Wash. ; 96 Pac. 160.

[2] See generally with reference to practice the following guaranty insurance cases: U. S. Fid. & Guar. Co. *v.* Carter, etc., 26 Ky. 665; Olds, *et al.* *v.* City Tr. Safe Dep. & Sur. Co., 18 Mass. 1; Todd *v.* Franzog, Wash. ; 87 Pac. 831; Am. Sur. Co. *v.* U. S., 133 Fed. 1019; Perrious *v.* Pac. Coats Co., 133 Fed. 140; U. S. Fid. & Dep. Co. of Md., 147 Fed. 228; Nat. Sur. Co. *v.* Cinn. N. O. & T. R. Ry. Co., 145 Fed. 34; Finney *v.* Am. Bond. Co., *et al.*, Ida. ; 90 Pac. 859; U. S. *v.* Churchyard, 132 Fed. 82; U. S. Fid. & Guar. Co. *v.* Schiff, *et al.*, 104 N. Y. Sup. 396; Bamberger *v.* U. S. Fid. & Guar. Co., 75 N. Y. Sup. 1005; Merkley & Sons *v.* U. S. Fid. & Guar. Co., 24 Ky. L. Rep. 2308; Romine *v.* Howard, Tex. ; 93 S. W. 690; Am. Sur. Co. of N. Y. *v.* Ballman, *et al.*, 115 Fed. 292; Glen Cove Co. *v.* City Tr. Safe Dep. & Sur. Co., 114 Fed. 978; Drumheller *v.* Am. Sur. Co., 30 Wash. 530; Flynn *v.* Union

§ 301. **Venue of Actions.** — From the standpoint of both the insurer and the insured, as well as the "risk," it becomes important to determine just where the proper place for trial may be of controversies arising either between the insured and the insurer or between the insurer and the "risk." As a general thing this matter is to be determined wholly by reference to the local statutes of the state wherein the action is brought. The only difficulty likely to arise is where the defendant is a guaranty insurance company organized under the laws of a foreign state and has no corporate habitat or residence within the state where the action is brought. By way of suggestion, with a view to meeting the difficulties that may arise in this connection, attention is called, without comment thereon, to the cases cited in the notes.[1]

Under a statute requiring a foreign corporation, having a place of business in the state, to appoint the commissioner of corporations its attorney, upon whom process might be served in any action against it, and providing that the authority of the commissioner to accept service should continue so long as any liability remained outstanding against the corporation in the state, a non-resident of the state has the same right to sue therein as a citizen, and may maintain an action against the corporation after it has ceased to do business there, so long as suits against it by the citizens of the state are pending, or until it is decided that at the time of the bringing of the action no liabilities against the corporation exist in the state.[2]

Sur. & Guar. Co., 170 N. Y. 145; 6 Bedell 1006; Fid. & Dep. Co. *v.* U. S. to Use of Smoot, 181 U. S. 315; 47 L. E. 194; Pervanger *v.* Union Cas. & Sur. Co., Miss. ; 32 Sou. 909; Iowa Tillioost Gold Mining Co., Ltd. *v.* U. S. Fid. & Guar. Co., 146 Fed. 437; Supreme Ruling of Fraternal Mystic Circle *v.* Nat. Sur. Co., 99 N. Y. Sup. 1034; Lyman *v.* F. & C. Co., 65 N. Y. App. Div. 327; Haines *v.* Hein, 67 N. Y. App. Div. 389; Bateman Bros. *v.* Am. Sur. Co. of N. Y., *et al.*, Cal. ; 78 Pac. 734; Cohen *v.* Am. Sur. Co., N. Y. ; 84 N. E. 947; U. S. to the Use of Vt. Marble Co. *v.* Burgdorf, 13 D. C. App. 506.

[1] Eickhoff *v.* F. & C. Co. of N. Y., 74 Minn. 139; 76 N. W. 1030; Easley *v.* Ins. Co., 38 Pac. Rep. 405; Am. Sur. Co. *v.* Holly Springs, 77 Miss. 428; 27 Sou. Rep. 612.

[2] Youmans *v.* Minn. Tit. Ins. & Tr. Co., 67 Fed. Rep. 282. See

§ 302. **The Right of Removal from State to United States Courts.** — A marked tendency is everywhere to be observed on the part of insurance companies to remove actions brought against them for trial, wherever possible, from the state to the United States courts. In this connection it may be observed that frequent attempts have been made by the legislatures of the several states to deprive foreign insurance companies of the right to remove all such actions from the state to the federal courts. Such legislation is clearly unconstitutional, for the reason that foreign insurance companies, being citizens of the state where it is corporated, within the meaning of the "Removal Act," cannot, under the Constitution of the United States, be deprived of the right to remove cases brought against them from the state to the federal courts.[1] Nevertheless, the purpose of such legislation may be indirectly accomplished by revoking the license granted to foreign insurance corporations to do business within the state, where such license is required by statute, and the motive which induces such action on the part of the state in so doing is not ordinarily a subject for judicial inquiry.[2]

§ 303. **Equitable Jurisdiction of Suits brought by the Insured against the Insurer to recover under Policies of Guaranty Insurance.** — It not infrequently happens, particularly in the case of fidelity insurance policies, that the trial of actions between the insured and the insurer, under such policies, necessarily involves the taking of a long and complicated account. In states where statutes exist allowing a compulsory reference in such cases as a matter of right to either party,

also the following cases: Morris, *et al.* *v.* George, Ga. ; 59 S. E. 1116; Hockwald *v.* Am. Sur. Co. of N. Y., Bernstein *v.* Same, Allen *v.* Same, Levy *v.* Same, Tex. Civ. Ct. of App. ; 102 S. W. 181; Whiteman County *v.* Rby., *et al.*, Wash. ; 94 Pac. 906.

[1] Home Ins. Co. *v.* Morse, 20 Wallace U. S. 445.

[2] Doyle *v.* Conn. Ins. Co., 94 U. S. 55; Hartford Fire Ins. Co. *v.* Raymond, 70 Mich. 485; see generally Guar. Co. *v.* Bank, 95 Va. 480; 28 S. E. 909; Am. Sur. Co. *v.* Lawrenceville Cem. Co., *et al.*, 96 Fed. 25; 110 Fed. 717; Olds, *et al.* *v.* City Tr. Safe Dep. & Sur. Co., 61 N. E. 223; Hollister *v.* U. S. Fid. & Guar. Co., 87 N. W. 776.

the advantages of a bill in equity, under the chancery practice, are thereby obtained, and the intervention of a jury rendered unnecessary.[1]

However, in the absence of statute, it is not clear by any means that equity can take jurisdiction of such actions except with the consent of both parties. The general subject of equity jurisdiction of suits between the insured and the insurer in the domain of guaranty insurance was touched upon by the United States court of appeals (fifth circuit) in the case of Guarantee Company of North America *v.* Mechanics Savings Bank and Trust Company.[2] As what is therein said has some direct bearing on the matter now under discussion, the following excerpt from the opinion in that case is here given: "This is a bill in equity," observed the court, "to recover on a contract of fidelity insurance. Equitable jurisdiction was asserted on the ground that the examination of a complicated account not convenient to be examined in a court of law, and also on the ground that there are quite a number of credits to be allowed the defendant in the account, the proper mode of applying which required the action of a chancellor. A stipulation filed in the case above shows that both parties preferred the equity jurisdiction, and no objection is made to it in this court. It may be doubtful whether, if the point has been sharply contested by demurrer below, the equity of the bill could have been maintained. It is true that there is a concurrent jurisdiction of matters of account in law and equity. But it is laid down that where all the items of account are on one side, and no discovery is asked, there is no equity jurisdiction. It is true that there are a few large items of credits, but it is not clear that they would make the account a mutual one, in the sense in which it is understood

[1] See Brillon Lumber Co. *v.* Barnard, *et al.*, 131 Wis. 284; 111 N. W. 483; Aronin *v.* Phila. Cas. Co., 104 N. Y. Sup. 110; Roberts *v.* Am. Bond. & Tr. Co., 83 Ill. App. Ct. 463; Pierce *v.* Equitable Life Assur. Soc., 145 Mass. 56; F. & C. Co. of N. Y. *v.* St. Matthews Sav. Bank, 104 Fed. 858; 44 C. C. A. 225.

[2] 80 Fed. 766; 26 C. C. A. 146.

in equity. However this may be, we think it is our duty to proceed to consider the cause on the merits." It is the constitutional right to trial by jury in such cases that is preserved in state courts by state constitutions, and in the United States courts by the United States Constitution, that stands in the way of the determination of such actions by the court sitting in chancery.[1]

§ 304. **The Right of the Insurer to go into Equity prior to a Settlement of Claim for Loss by the Insured, for the Purpose of compelling the "Risk" to settle such Claim.** — A somewhat different question from that referred to in the preceding section arises when the aid of a court of equity is invoked by the insurer for the purpose of compelling the "risk" to satisfy a liability of the insurer to the insured already incurred under the policy through acts of such "risk."

The reason for this is the fact that a fiduciary relationship exists between the insurer and the "risk." Story, in his work on Equity,[2] states that "principals and sureties stand in a fiduciary and confidential relation, and that the same principles apply to them as to the other parties sustaining fiduciary relations one to the other." In Robinson *v.* Pope [3] it was said "that the phrases 'confidential relation' and 'fiduciary relation' seem to be used by the court and law writers as convertible terms. It is a peculiar relation which undoubtedly exists between principal and agent, principal and surety, etc." The term "fiduciary" involves the idea of trust and confidence. It contemplates good faith, rather than legal obligations, as to the basis of the transaction.

This matter, in a somewhat involved form, was before the Supreme Court of Wisconsin in Dobie *v.* Fidelity and Casualty Company.[4] Before the ruling of that court can be understood,

[1] Uhlman *v.* N. Y., etc. Ins. Co., 109 N. Y. 421; see Central Tr. Co. *v.* Louisville Tr. Co., 100 Fed. 545; 40 C. C. A. 530; Brillon Lumber Co. *v.* Barnard, *et al.*, 131 Wis. 284; 111 N. W. 483; Aronin *v.* Phila. Cas. Co., 104 N. Y. Sup. 110; Roberts *v.* Am. Bond. & Tr. Co., 83 Ill. App. Ct. 463.

[2] Vol. I, p. 323.

[3] 57 Cal. 496.

[4] 95 Wis. 540; 70 N. W. 482.

a brief statement of the material facts of the case will be necessary.

It appears that one Anderson obtained a judgment against the firm of Burke Brothers in an action for personal injuries. The Fidelity and Casualty Company was an insurer for the Burkes under an employers' liability policy, and defended the action brought against the latter by Anderson. Thereafter it induced Dobie to become the surety on an appeal bond given therein, and in connection therewith gave him an indemnifying bond conditioned to answer for all damages, interests and costs, if any, that might be adjudged against it on the appeal, and to save him harmless from all damages and costs on account of his obligation as surety. Judgment went against the Fidelity and Casualty Company on the appeal, and Dobie thereby became liable on the appeal bond. Thereupon he brought an action to compel the Fidelity and Casualty Company to pay the judgment rendered on the appeal, and so exonerate him from liability; this, too, without first paying the judgment himself. Passing upon the question of law thus presented, the Wisconsin Supreme Court spoke as follows:

> "The action is by a surety to compel his principal to pay the debt for which both are liable, for the exoneration of the surety. It is ultimately the Fidelity and Casualty Company's liability. That party is the principal debtor who is ultimately liable for the debt. The question is whether a surety can in equity compel his principal to exonerate him from liability by extinguishing the obligation, without having first paid it himself. It seems to be well settled that a surety against whom a judgment has been rendered may, without making payment himself, proceed in equity against his principal to subject the estate of the latter to the payment of the debt in exoneration of the surety."

Without denying that the Wisconsin court was not without some precedents upon which to base its holding in the case just referred to, it still must be admitted that the weight of judicial authority is against it on this question. Thus in American Bonding and Trust Company *v.* Logansport and

West Virginia Gas Company,[1] it was held that an insurer which had issued an injunction bond could not maintain a suit in equity against the " risk " in the nature of a bill *quia timet* to require indemnity against the liability incurred, where he has paid nothing on account of it, and the suit in which the bond was given is still pending on appeal and undetermined, until which time there is no liability on the bond on the part of the " risk " or the insurer. In its opinion in the case the court said:

"Wherever an insurer signs an obligation with a 'risk,' the law raises an implied agreement to indemnify the insurer against all loss and damage by reason of his suretyship. . . . As soon as the contract of suretyship is entered into, it is firmly settled that the law raised an implied promise on the part of the principal to indemnify the surety against any loss to which he may be subjected by reason of the contract, and it is equally well settled that the surety cannot recover from the principal until a loss has been actually paid by the surety. . . . Where the liability of the principal to make such payment has been finally established by the judgment of the Supreme Court, it will be time enough to pay or to give indemnity to pay."

The doctrine of the foregoing case is in full accord also with that of American Surety Company *v.* Haynes.[2] Here it was said that the insurer's relation to an action brought to compel a " risk " to make indemnity is fixed by contract. It contracted with a third party to insure the fidelity of the defendant, and when it paid any money on that contract, and not until then, did it have a case of action against the " risk." In other words, the embezzlement by the defendant of the money of the railway company (the insured) in and of itself creates no cause of action in favor of the insurer against the " risk." The insurer must have indemnified the insured before it could have a cause of action against the " risk," and then only because of the fact that it had paid out money for the use and benefit of the " risk." Having so paid such money, the law raises a promise on the part of the " risk " to repay the same to the insurer. It is on this implied promise

[1] 95 Fed. 49. [2] 91 Fed. 90.

only that the insurer has any standing in court to recover the money sued for.

In general it appears to be the better and more generally accepted rule that a court of equity cannot compel an indemnitor to comply with his obligation in advance of the contingency upon which by such obligation he was to become liable. This principle rests upon the distinction, not always recognized by the courts, existing between the relation of surety and principal and that of indemnitor and indemnitee.[1]

A surety cannot be required to wait until he has made payment before he may go into equity and compel his principal to pay his debt. A surety has the right as against his principal to be protected from loss by reason of his suretyship so far as it can be done without prejudice to the rights of the creditor. The doctrine in such cases rests upon the simple right, that as between the principal and the surety the surety is to be protected by the principal. The form in which that protection may be secured is not material where the right to its exists and it can be had without prejudice to the creditor. The obvious duty of the principal to perform must exist before its performance will be enforced, and if added to that there is a prevention of circuity of action, a plain case ordinarily exists.[2]

§ 305. **Right of the Insurer to go into Equity subsequent to a Settlement of Claim for Loss with the Insured, for the Purpose of compelling the "Risk" to make Indemnity.** — It frequently becomes of great importance to the insurer, in an action brought by it against the "risk" to compel indemnification, to induce a court of equity to assume jurisdiction thereof. Where a long and complicated account is involved, it amounts almost to a denial of justice to be forced to submit such claims to a jury for determination. The question then comes up, on

[1] Central Tr. Co. *v.* Louisville Tr. Co., 100 Fed. 545; 40 C. C. A. 530.

[2] Roberts *v.* Am. Bond. & Tr. Co., 83 Ill. App. Ct. 463; see also Conklin, *et al.* *v.* U. S. Ship Bldg. Co., 136 Fed. 1006; Stanford *v.* U. S. Fid. & Guar. Co., Ga. ; 43 S. E. 61; Aronin *v.* Phila. Cas. Co., 104 N. Y. Sup. 110.

what grounds can the jurisdiction of equity be invoked? The answer to this is, if it can be invoked at all, it must be on the ground of the existence of a fiduciary relationship and the necessity for an accounting to ascertain the amount of the "risk's" liability to the insurer. But the question may be well asked, why has not this amount been fully ascertained by the sum paid by the insurer to the insured in settlement? This was evidently the view taken by the court in King *v.* Insurance Company, already cited.[1] To return now to the question of equitable jurisdiction, attention is called to the words of the court in the leading case of Marvin *v.* Brooks.[2] It was there said that "the basis of equitable jurisdiction over matters of account appears to have been seldom considered in our courts, but often discussed by the English authorities. We have been referred to many of these, but they seem to us not harmonious, and occasionally difficult to reconcile. The best considered review of the authorities puts the equitable jurisdiction upon these grounds, viz.: The complicated character of the accounts, the need of a discovery, and the existence of a fiduciary or trust relation." In those states where a compulsory reference may be had where a case involves the taking of a long and complicated account, most of the benefits of a resort to equity may be had by proceedings to obtain a reference to take the account and report thereon to the court. This whole question was before the Wisconsin Supreme Court for a consideration in Brillon Lumber Company *v.* Barnard, *et al.*,[3] on an application under the Wisconsin statute authorizing the granting of compulsory references to determine the issues of fact, on the ground that they require the examination of a long account. The court in granting such a reference spoke as follows:

"§ 2864, Stat. 1898, provides that a compulsory reference may be granted 'when the trial of an issue of fact shall require the examina-

[1] 74 Law Times, 206; see also Guar. Co. of N. A. *v.* Pitts, 30 Sou. 758; *ante*, § 205.

[2] 94 N. Y. 75.

[3] 131 Wis. 284; 111 N. W. 483.

tion of a long account on either side; in which case the referee may be directed to hear and decide the whole issue.' So, if the essential of a reference existed, *i.e.* the necessity of an examination of a long account, it was within the court's discretion to refer that only, or that and other issues or all the issues. How long an account must be to satisfy the statute is very much a matter of judgment on the part of the trial court, but it has been held that twenty or more items are sufficient,[1] and that it will do if a long account must be proved by the plaintiff in making out his case, even though the defendant has denied all liability,[2] and again if the plaintiff's case depends on proving a long account the reference may be granted.[3] We do not understand that in order to justify a reference the action must be strictly based on the account or for an accounting. The language of the statute clearly indicates the contrary. If 'the trial of an issue of fact shall require the examination of a long account on either side,' then, according to the express language of the statute, the reference may be directed either as to the whole issue or any specific question of fact involved. We are unable to find anything in Andrus *v.* Home Insurance Company, of New York,[4] or Jordan *v.* Warner,[5] restricting the statute within the very narrow limits contended for. True, mere items of damage do not constitute an account, and likewise true there must be an account in the proper sense, and it must be something more than a mere incidental matter. It must be a matter forming substantially the basis of the plaintiff's claim, though the action need not be on the account nor for an accounting. References have been sustained in actions of this nature because of the necessity of examining the principal obligor's account to ascertain the amount of his defalcation and determine the extent of the liability of the surety upon the bond. Such cases are referable because the account is a matter directly involved in the main issue.[6] So it is sufficient if there is a long account in the proper sense which is directly, not merely collaterally, involved, so that it must, in the regular course of the trial, necessarily be examined as forming substantially the basis of the claim for a recovery.

"Here the entire claim of the plaintiff was put in issue by the an-

[1] Turner *v.* Nachtsheim, 7 Wis. 16; 36 N. W. 637.

[2] U. S. R. S. Co. *v.* Johnston, 67 Wis. 182; 30 N. W. 211.

[3] Briggs *v.* Hill, 79 Wis. 571; 48 N. W. 800.

[4] 73 Wis. 642; 41 N. W. 956; 3 L. R. A. 271.

[5] 107 Wis. 539–550; 83 N. W. 946.

[6] Board of Supervisors of Dane County *v.* Dunning, 20 Wis. 210; Cairns *v.* O'Bleness, 40 Wis. 469; Andrus *v.* Home Ins. Co. of N. Y., *supra.*

swer. It was clear from the complaint that such claim involved a long account of numerous transactions of a debit and credit covering over nine months' time. True, much of this, when it came to trial, was not disputed, but the state of the pleadings was such that it was incumbent on the plaintiff to prove by evidence the entire account as to lumber sent to the yard and as to sales reported and collections turned in. Each and all of the matters involved were open to dispute under the pleadings. That made, within the authorities, a good cause for a reference, even without any aid from statements made in open court by counsel showing the extent to which items or matters relating to the account would probably be disputed."

In making an application for a reference to the court, it should be supported not only by proper allegations in the pleadings, placed there with this particular object in view, but it should be supported by affidavits, and the motion for a reference might be based on any or all of the following six grounds, to wit:

1. That the action is equitable in its nature.

2. That a full, adequate and complete remedy cannot be had at common law.

3. Because the trial of the issues of fact will require an examination of a long account.

4. Because a discovery is necessary.

5. On the ground that a fiduciary relationship exists between the insurer and the "risk."

6. On the ground that the trial of the issues of fact in the action involves an examination of accounts too long and too complicated for intelligent determination by a jury.[1]

[1] See generally, on questions of practice under guaranty insurance policies, the following cases: Standard Oil Co. of N. Y. *v.* F. & C. Co. of N. Y., 51 S. W. 571; U. S. Cas. & Sur. Co. *v.* Schwerin, 80 Fed. 638; 26 C. C. A. 45; Guthrie *v.* Indemn. Co., 101 Tenn. 643; Bacon *v.* Am. Sur. Co., 53 N. Y. App. Div. 150; F. & C. Co. of N. Y. *v.* Phœnix Mfg. Co., 100 Fed. Rep. 604; 40 C. C. A. 614; Schwartz *v.* Fid. & Dep. Co. of Md., 24 Sou. 479; Am. Sur. Co. of N. Y. *v.* Lawrenceville Cem. Co., *et al.*, 96 Fed. 25; 110 Fed. 717; Rice *v.* Fid. & Dep. Co. of Md., 103 Fed. 427; Guar. Co. of N. A. *v.* First Nat. Bank of Lynchburg, 95 Va. 480; 28 S. E. 909; Union Guar. & Tr. Co. *v.* Craddock, 59 Ark. 593; 28 S. W. 424; Nat. Sur. Co. *v.* Arterburn, 62 S. W. 862; Nat. Sur. Co. *v.* T. B. T. Br.

CHAPTER XXV

PLEADING

§ 306. **The Complaint in an Action brought by the Insured against the Insurer under a Policy of Guaranty Insurance.** — The complaint, in order to state facts sufficient to constitute a cause of action, should clearly and succinctly contain the following averments:

First. Allegation as to the status of the plaintiff.[1]

Second. Allegation as to the status of the defendant.[2]

Third. Allegation as to the issuance of the policy by the insurer to the insured and the payment of the consideration therefor.[3]

Fourth. Allegation setting forth the policy in substance, or attaching a copy thereof to the complaint as an exhibit therein.[4]

Fifth. If the proposal or application for the policy is made a part thereof, these should be set forth either in substance or by copies properly referred to as exhibits therein.[5]

Sixth. Allegation setting forth the nature and extent of the liability under the policy sought to be enforced in the action.[6]

& Con. Co., 74 Ill. App. 312; 176 Ill. 156; 52 N. E. 938; Sheldon *v.* Fid. Tr. & Guar. Co., 71 N. Y. Sup. 65; Bank of Tarboro *v.* Fid. & Dep. Co., 35 S. E. 588; see generally U. S. *v.* Am. Sur. Co., 120 Fed. 913; U. S. Fid. & Guar. Co. *v.* Hampton, *et al.*, 134 Fed. 734.

[1] Northern Assurance Company of England *v.* Borgelt, *et al.*, 67 Neb. 282; 93 N. W. 226.

[2] See F. & C. Co. *v.* Eickhoff, 63 Minn. 170; 65 N. W. 351; Guar. Co. *v.* Nat. Bank, 95 Va. 480; 28 S. E. 909; Union Guar. etc. Co. *v.* Craddock, 59 Ark. 593; 28 S. W. 424.

[3] Bank of Timmonsville *v.* F. & C. Co., 120 Fed. 315.

[4] See Coldham *v.* Am. Cas. & Secur. Co., 8 O. Cir. Ct. 620.

[5] See Ulster *v.* T. & G. Co. of N. Y., 69 Mo. App. 186.

[6] See F. & C. Co. of N. Y. *v.* Eickhoff, 63 Minn. 170; 65 N. W. 351; A. F. S. H. Co. *v.* Knipperberg, *et al.*, 65 Pac. 621; F. & C. Co. *v.* Lawler, *et al.*, 64 Minn. 144; 66 N. W. 143; Standard Oil Co. *v.* F. & C. Co. of N. Y., 51 S. W. 871.

Seventh. Allegation alleging the performance of all conditions precedent. To this is sometimes added an allegation of compliance with all the warranties contained in the policy.[1]

It has been held, however, that it is not necessary for the insured, in an action on a policy of guaranty insurance, to aver in his complaint and prove at the trial the truth of representations amounting to warranties which are contained in the application only, in order to entitle him to recover thereon. In such a case it is incumbent upon the insurer, if he wishes to rely upon a breach of such warranty, to allege it and assume the burden of proof as to such allegation.[2]

Eighth. Allegations showing the manner and time of furnishing notice and proof of loss.[3]

Ninth. Non-payment of loss, and the refusal of the insurer to pay the same.[4]

In addition to the foregoing, the following incidental matters may be here referred to.

It is safer practice to allege affirmatively that the insured (if a foreign corporation) had a license to do business in the state.[5]

In California Savings Bank *v.* American Surety Company,[6] it was said that the insured, in an action on the policy, must allege facts showing that three months had elapsed after proof

[1] See Earle *v.* Fid. & Dep. Co., N. J. ; 68 Atl. 1078; Hester *v.* F. & C. Co. of N. Y., 69 Mo. App. 186; Cal. Sav. Bank *v.* Am. Sur. Co., 82 Fed. 866; T. M. Sinclair & Co. *v.* Nat. Sur. Co., 132 Ia. 542; 107 N. W. 184; U. S. Fid. & Guar. Co. *v.* Trustees of Baptist Church, Ky. Ct. of App. ; U. S. Fid. & Guar. Co. *v.* Donnelly, N. J. Ct. of App. ; 54 Atl. 457; U. S. *ex rel.* McAllister *v.* Fid. & Dep. Co., 83 N. Y. Sup. 752; 86 App. Div. 475; U. S. Fid. & Guar. Co. *v.* Commonwealth, for Use of, etc., 31 Ky. L. Rep. 35; Guist *v.* Am. Bond. & Tr. Co., 74 Neb. 692; First Nat. Bank *v.* Fid. & Dep. Co., Ala. ; 40 Sou. 415; Am. Bond. & Tr. Co. *v.* Burton, 30 Ky. L. Rep. 703; Saul *v.* U. S. Fid. & Guar. Co., 75 N. Y. Sup. 715.

[2] Am. Cr. In. Co. *v.* Wood, 73 Fed. 265; 19 C. C. A. 264; Bank of Tarboro *v.* Fid. & Dep. Co., 35 S. E. 588; 126 N. C. 320.

[3] See Coldham *v.* Am. Cas. & Secur. Co., 8 O. Cir. Ct. 620; Cal. Sav. Bank *v.* Am. Sur. Co., 82 Fed. 866.

[4] See Cal. Sav. Bank *v.* Am. Sur. Co., 82 Fed. 866.

[5] Wood & Selick *v.* Ball, 190 N Y. 217; Halsey *v.* Jewett Oranatic Co., 190 N. Y. 231.

[6] 82 Fed. 866.

of loss and before the action was brought. It was also suggested that an allegation that the loss was discovered within six months from the death, dismissal or retirement of the "risk" is essential to a correct statement of the insured's case of action.

An allegation that the insured had been fully advised and informed of the breaches of the policy has been held not to dispense with the necessity of alleging and proving the furnishing of loss.[1] So again it has been said that the insured need not allege the truth of the statements in the application, or non-performance of conditions subsequent nor negative prohibited acts or exceptions, or allege that his claim is not within the excepted causes of loss.[2]

A declaration which sets out the insured's cause of action with sufficient clearness and fulness to apprise the insurer of the ground of the former's claim and enable the latter to plead, is sufficient.[3] In Fidelity and Casualty Company of New York *v.* Eickhoff,[4] it was held that where a policy covers acts of fraud and dishonesty on the part of the "risk," it is not necessary to allege specifically that the loss sued for was caused by acts of fraud or dishonesty on the part of such "risk," where the complaint contains other allegations showing the manner in which the loss occurred and the nature thereof.

§ 307. **Defences to Actions brought by the Insured against the Insurer under Policies of Guaranty Insurance.** — Without attempting to do more than outline in a general way the nature of defences that may be interposed by the insurer to actions brought against it by the insured under policies of guaranty insurance, the principal defences here referred to may be enumerated as follows:

First. Denial of any loss coming within the scope of liability under the policy. In this defence the element of time when the loss occurred, and the element of cause with respect

[1] Cal. Sav. Bank *v.* Am. Sur. Co., 82 Fed. 866.

[2] Hester *v.* F. & C. Co., 69 Mo. App. 186.

[3] Guar. Co. *v.* Bank, 95 Va. 480; 28 S. E. 909.

[4] 63 Minn. 170; 65 N. W. 351.

to the nature of the loss, may be offered as a separate defence or defences. This also includes the defence that the loss for which recovery is sought is covered by the "excepted causes" enumerated in the policy.[1]

Second. Fraud in obtaining the policy.[2]

Third. Non-payment of premium.[3]

Fourth. Misrepresentation.[4]

Fifth. Concealment.

Sixth. Breach of Warranty.[5]

Seventh. Breach of Conditions.[6]

Eighth. Alteration of the contract had between the insured and the "risk" occurring subsequent to the issuance of the policy in suit.[7]

Ninth. Release of the liability of the "risk" to the insured by the latter to the former.

Tenth. Impairment of the insurer's right of subrogation through acts of the insured.

Eleventh. Failure of the insured to furnish notice and proof of loss as required by the policy.

Twelfth. Limitation of the right of action either by statute or by special provisions of the policy.

Thirteenth. Allegation that the policy issued was against public policy or was contrary to law.[8]

Fourteenth. Estoppel or waiver of right to claim an existing liability under the policy as against the insurer.

Fifteenth. That the court has no jurisdiction of the defendant.[9]

[1] See Am. Bond. Co. *v.* Dufur, *et al.*, Wash. ; 96 Pac. 160.

[2] Roark *v.* City Tr. Safe Dep. & Sur. Co., Ark. ; 110 S. W. 1.

[3] Baston *v.* Fid. Mut. Life Ins. Co., Ala. ; 46 Sou. 578.

[4] See Guar. Co. *v.* Bank, 95 Va. 480; 28 S. E. 909.

[5] Am. Cr. Ins. Co. *v.* Wood, 73 Fed. 265; 19 C. C. A. 264.

[6] See Pickett *v.* F. & C. Co. of N. Y., 38 S. E. 160; Har. S. & L. Ass. *v.* U. S. Fid. & Guar. Co., 46 Atl. 910.

[7] U. S. *v.* M'Intyre & U. S. Fid. & Guar. Co., 111 Fed. 590; Har. S. & L. Ass. *v.* U. S. Fid. & Guar. Co., 46 Atl. 910.

[8] Goodwillie *v.* London Guar. & Acc. Co., 108 Wis. 207; 84 N. W. 164.

[9] F. & C. Co. of N. Y. *v.* Everett, 97 Ga. 787; 25 S. E. 734.

A plea to the jurisdiction of the court in a transitory action which fails to state that the cause of action did not arise within the jurisdiction of the court, or where it did arise, and which fails to show what court of the state has jurisdiction of the cause, is bad. As a general rule, such plea must show a more proper and sufficient jurisdiction in some other court of the state or country wherein the action is brought.[2] A plea in abatement which sets up two or more distinct and sufficient defences, either of which, if true, would necessitate a finding in favor of the defendant tendering the plea, is bad for duplicity.[1]

[1] Guar. Co. *v.* Bank, 95 Va. 480; 28 S. E. 909.

[2] Guar. Co. *v.* Bank, 95 Va. 480; 28 S. E. 909. See generally in this connection the following cases: U. S. Fid. & Guar. Co. *v.* Dampiskbaktieselskabet Habil, Ala. ; 35 Sou. 344; U. S. *v.* Am. Sur. Co., 155 Fed. 941; Am. Bond. Co. *v.* Mills, 152 Fed. 107; Wing *v.* Bostwick Co. *v.* U. S. Fid. & Guar. Co., 150 Fed. 672; Kan. City Hydraulic Press Brick Co. *v.* Nat. Sur. Co., 157 Fed. 620; Mossein *v.* Em. St. Sur. Co., 98 N. Y. Sup. 144; Mich. S. S. Co. *v.* Am. Bond. Co., 95 N. Y. Sup. 1034; U. S. Fid. & Guar. Co. *v.* Hampton, *et al.*, 134 Fed. 734; U. S. *ex rel.* Schauffer *v.* Fid. & Dep. Co., 155 Fed. 117; N. Y. Co. Nat. Bank *v.* Am. Sur. Co. of N. Y., 74 N. Y. Supp. 693; T. M. Sinclair & Co. *v.* Nat. Sur. Co., 132 Ia. 542; 107 N. W. 184; Whitman Co. *v.* Ravy, *et al.*, Wash. ; 94 Pac. 906; Northern Assur. Co. of England *v.* Borgelt, *et al.*, Neb. ; 93 N. W. 226; Perpetual Bldg. & Loan Ass. *v.* U. S. Fid. & Guar. Co., Ia. ; 92 N. W. 686.

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